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Rising Above: Recent Trends and Transformations in Bankruptcy Appellate Cases

Hon. Michael A. Fagone, Moderator
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Appellate Trends

Hon. Michael A. Fagone U.S. Bankruptcy Court | Bangor, ME
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Blockbuster Cases and Circuit Splits

1. *United States v. Miller*, 145 S. Ct. 839 (2025)
2. Discharge Exceptions in Subchapter V
3. *In re PREPA*, 121 F.4th 280 (2024)
4. *Soussis v. Macco*, 136 F.4th 415 (2d Cir. 2025)
5. Solvent Debtors (*LTL Mgmt.*, *Bestwall*)
6. *Purdue Pharma* Fallout
7. *Serta Simmons*, 125 F.4th 555 (5th Cir. 2024)

United States v. Miller

- ◇ 11 U.S.C. § 544(b)(1) provides:
 - ◇ Except as provided in paragraph (2), **the trustee may avoid any transfer** of an interest of the debtor in property or any obligation incurred by the debtor **that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502** of this title or that is not allowable only under section 502(e) of this title.
- ◇ 11 U.S.C. § 106(a) provides, in part:
 - ◇ Notwithstanding an assertion of sovereign immunity, **sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to** the following:
 - ◇ (1) Sections 105, 106, 107, 108, 303, 346, 362, 363, 364, 365, 366, 502, 503, 505, 506, 510, 522, 523, 524, 525, 542, 543, **544**, 545, 546, 547, 548, 549, 550, 551, 552, 553, 722, 724, 726, 744, 749, 764, 901, 922, 926, 928, 929, 944, 1107, 1141, 1142, 1143, 1146, 1201, 1203, 1205, 1206, 1227, 1231, 1301, 1303, 1305, and 1327 of this title.
 - ◇ ...
 - ◇ (5) **Nothing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law.**

Discharge Exceptions for Small Businesses

- “A discharge under this chapter does not discharge a debtor **who is an individual** from any debt excepted from discharge under section 523 of this title.” 11 U.S.C. § 1141(d)(2).
- “Notwithstanding paragraph (1), the confirmation of a plan does not discharge a debtor **that is a corporation** from any debt (A) **of a kind** specified in paragraph (2)(A) or (2)(B) of section 523(a).”
- “A discharge under section 727, 1141, 1192, 1228(a), 1228(b), or 1328(b) **does not discharge an individual debtor** from any debt ... [followed by several discharge exceptions].” 11 U.S.C. § 523(a).
- “[T]he court shall grant the debtor a discharge of all debts ... except any debt ... **of the kind** specified in section 523(a) of this title.” 11 U.S.C. § 1192.
- “[T]he court shall grant the debtor a discharge of all debts ... except any debt ... **of a kind** specified in section 523(a) of this title.” 11 U.S.C. § 1228.

The State of Play

- Three appellate courts
 - Cantwell-Cleary Co., Inc. v. Cleary Packaging, LLC (*In re Cleary Packaging, LLC*), 36 F.4th 509, 512 (4th Cir. 2022) (yes).
 - Avion Funding, LLC v. GFS Indus., LLC (*In re GFS Indus., LLC*), 99 F.4th 223, 232 (5th Cir. 2024) (yes).
 - BenShot, LLC v. 2 Monkey Trading, LLC (*In re 2 Monkey Trading, LLC*), No. 23-12342 (11th Cir. July 9, 2025) (yes).

LUCK, Circuit Judge, dissenting:

The majority of our nation's bankruptcy courts that have reached the issue, *see, e.g., In re Off-Spec Sols., LLC*, 651 B.R. 862, 865–72 (B.A.P. 9th Cir. 2023); *In re R&W Clark Constr., Inc.*, 656 B.R. 628, 633–39 (Bankr. N.D. Ill. 2024), *rev'd*, No. 24 CV 1463, 2024 WL 4789403 (N.D. Ill. Nov. 14, 2024); *In re GFS Indus., LLC*, 647 B.R. 337, 341–52 (Bankr. W.D. Tex. 2022), *rev'd*, 99 F.4th 223 (5th Cir. 2024); *In re Lapeer Aviation, Inc.*, No. 21-31500-JDA, 2022 WL 1110072, at *2 (Bankr. E.D. Mich. Apr. 13, 2022); *In re Cleary Packaging LLC*, 630 B.R. 466, 470–76 (Bankr. D. Md. 2021), *rev'd*, 36 F.4th 509 (4th Cir. 2022); *In re Ritch Fabrications, LLC*, 635 B.R. 559, 563–66 (Bankr. D. Idaho 2021); *In re Satellite Rests. Inc. Crabanker Factory USA*, 626 B.R. 871, 874–79 (Bankr. D. Md. 2021), including every bankruptcy court in our circuit, *see, e.g., In re Davidson*, No. 23-30018, 2025 WL 511226, at *2–5 (Bankr. N.D. Fla. Feb. 14, 2025); *In re Ra Custom Design, Inc.*, No. 23-58494-SMS, 2024 WL 607716, at *1–3 (Bankr. N.D. Ga. Feb. 13, 2024); *In re Hall*, 651 B.R. 62, 67–69 (Bankr. M.D. Fla. 2023), have held that the nondischargeability provisions of 11 U.S.C. section 523(a) are not applicable to corporate debtors who confirm nonconsensual plans (cramdowns) under subchapter V. Because these courts have the best reading of the bankruptcy code, I respectfully dissent.

In re PREPA

121 F.4th 280 (1st Cir. 2024)

In re Soussis

- ◆ 11 U.S.C. § 1326(a)(2) provides:
 - ◆ A payment made under paragraph (1)(A) shall be retained by the trustee until confirmation or denial of confirmation. If a plan is confirmed, the trustee shall distribute any such payment in accordance with the plan as soon as is practicable. If a plan is not confirmed, the trustee shall return any such payments not previously paid and not yet due and owing to creditors pursuant to paragraph (3) to the debtor, after deducting any unpaid claim allowed under section 503(b).
- ◆ 28 U.S.C. § 586(e) provides, in part:
 - ◆ (1) The Attorney General . . . shall fix—
 - ◆ (A) a maximum annual compensation for [a standing chapter 13 trustee] . . . ; and
 - ◆ (B) a percentage fee not to exceed . . . ten percent[.]
 - ◆ (2) [A standing chapter 13 trustee] shall collect such percentage fee from all payments received by [the trustee] under plans

Solvent Debtors (*LTL Mgmt.*, *Bestwall*)

- A bankruptcy court must dismiss a chapter 11 petition under 11 U.S.C. § 1112(b) for lack of good faith when the debtor cannot show financial distress that is “apparent” and “immediate enough to justify a filing.” *In re LTL Mgmt.*, 64 F.4th at 102 (3d Cir. 2023) (Ambro, J.).
- Lack of financial distress does not deprive a bankruptcy court of subject matter jurisdiction under the Bankruptcy Clause of the U.S. Constitution. *Bestwall*, 658 B.R. at 370-71 (Bankr. W.D. N.C. 2024).

Purdue Pharma: Equity and Implications

Serta Simmons

125 F.4th 555 (5th Cir. 2024)



Thank you!

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United States v. Miller, 604 U.S. ---- (2025)

145 S.Ct. 839, 221 L.Ed.2d 373, 74 Bankr.Ct.Dec. 91, 2025 Daily Journal D.A.R. 2607...

Justice Gorsuch filed a dissenting opinion.

145 S.Ct. 839

Supreme Court of the United States.

UNITED STATES, Petitioner

v.

David L. MILLER

No. 23-824

|

Argued December 2, 2024

|

Decided March 26, 2025

Procedural Posture(s): Petition for Writ of Certiorari; On Appeal; Motion for Summary Judgment.

West Headnotes (40)

Synopsis

Background: Chapter 7 trustee, in his capacity as creditor holding allowable unsecured claim, brought strong-arm proceeding to avoid payments that corporate debtor had made to the Internal Revenue Service (IRS) on personal tax obligations of two of its principals. The United States moved, in effect, for summary judgment on sovereign immunity and preemption grounds, and trustee filed cross-motion. The United States Bankruptcy Court for the District of Utah, *R. Kimball Mosier*, J., 617 B.R. 375, granted trustee's motion, denied government's motion, and avoided the transfers. Government appealed. The District Court, *Bruce S. Jenkins*, Senior District Judge, 2021 WL 5194698, affirmed. Government appealed. The United States Court of Appeals for the Tenth Circuit, Baldock, Circuit Judge, 71 F.4th 1247, affirmed. Certiorari was granted.

[Holding:] The Supreme Court, Justice Jackson, held that the Bankruptcy Code abrogates sovereign immunity only with respect to the federal cause of action created by the subsection of the Code enabling a bankruptcy trustee to step into the shoes of a creditor and avoid certain transfers that would be “voidable under applicable law,” not with respect to the underlying state-law claims that supply the “applicable law” for that federal cause of action.

Reversed.

Chief Justice *Roberts* and Justices Thomas, Alito, Sotomayor, Kagan, Kavanaugh, and Barrett joined.

[1] Bankruptcy 🗝️ Trustee as representative of debtor or creditors

Bankruptcy Code empowers a bankruptcy trustee to “avoid,” or set aside, certain transfers of a debtor's assets in order to recover those assets for the benefit of the bankruptcy estate. 11 U.S.C.A. § 544(b).

[2] Bankruptcy 🗝️ Trustee as representative of debtor or creditors

Bankruptcy trustee's avoidance powers help the trustee maximize the value of the bankruptcy estate by enabling the trustee to recover assets that otherwise would have been lost.

[3] Bankruptcy 🗝️ Trustee as representative of debtor or creditors

Bankruptcy trustee's avoidance powers help the trustee equalize the distribution of the debtor's assets among creditors by preventing the debtor from offloading assets to preferred creditors outside of the formal bankruptcy process.

[4] Bankruptcy 🗝️ Statutory Liens

Bankruptcy Code permits a bankruptcy trustee to avoid the transfer of certain statutory liens. 11 U.S.C.A. § 545.

[5] Bankruptcy 🗝️ Preferences

Bankruptcy Code's preferences provision allows a bankruptcy trustee to invalidate transfers that the debtor made immediately before bankruptcy proceedings began. 11 U.S.C.A. § 547(b).

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[6] **Bankruptcy** 🗝️ **Fraudulent conveyances in general**

Bankruptcy Code permits a bankruptcy trustee to set aside certain fraudulent transfers, such as those made for the purpose of delaying or impeding the repayment of creditors. 11 U.S.C.A. § 548.

[7] **Bankruptcy** 🗝️ **Trustee as representative of debtor or creditors**

Term “applicable law,” as used in the subsection of the Bankruptcy Code enabling a bankruptcy trustee to step into the shoes of a creditor and avoid certain transfers that would be “voidable under applicable law,” can technically refer to any state or federal law outside of the Code, although trustees typically rely on state statutes to supply the “applicable law” for avoidance suits under that provision. 11 U.S.C.A. § 544(b).

[8] **Fraudulent Conveyances** 🗝️ **Protection of creditors**

Fraudulent Conveyances 🗝️ **Intent**

Fraudulent Conveyances 🗝️ **Insolvency element of fraud**

Fraudulent Conveyances 🗝️ **Sufficiency in general**

State fraudulent transfer laws aim to prevent debtors from hiding or shielding their assets from creditors; most do so by providing creditors with a cause of action to invalidate any transfer that a debtor made with the intent to defraud creditors, and creditors may also typically invoke such laws to void “constructive fraudulent transfers”—that is, transfers made without an actual intent to defraud, such as an insolvent debtor's sale or transfer of assets for something less than their equivalent value.

[9] **Bankruptcy** 🗝️ **Time of making transfer**

Statute of limitations, or “lookback period,” of the Bankruptcy Code's fraudulent-transfer provision is only two years. 11 U.S.C.A. § 548(a)(1).

[10] **Bankruptcy** 🗝️ **Trustee as representative of debtor or creditors**

To show that a debtor's transfer is “voidable under applicable law,” within meaning of the subsection of the Bankruptcy Code enabling a bankruptcy trustee to step into the shoes of a creditor and avoid certain transfers that would be “voidable under applicable law,” the trustee must identify the actual creditor or creditors who could have set aside the transaction in question under applicable law; if there is no creditor against whom the transfer is voidable under the applicable law, the trustee is powerless to act. 11 U.S.C.A. § 544(b).

4 Cases that cite this headnote

[11] **Bankruptcy** 🗝️ **Trustee as representative of debtor or creditors**

“Actual creditor” requirement of the subsection of the Bankruptcy Code enabling a bankruptcy trustee to step into the shoes of a creditor and avoid certain transfers that would be “voidable under applicable law” serves as an important check on the trustee's avoidance powers; absent the requirement, a trustee could use that provision of the Code to unwind transactions that would never actually be at risk of invalidation outside of bankruptcy proceedings. 11 U.S.C.A. § 544(b).

1 Case that cites this headnote

[12] **Bankruptcy** 🗝️ **Trustee as representative of debtor or creditors**

“Actual creditor” requirement of the subsection of the Bankruptcy Code enabling a bankruptcy

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trustee to step into the shoes of a creditor and avoid certain transfers that would be “voidable under applicable law” mitigates the disruptive potential of the trustee's avoidance power by ensuring that the trustee has no greater rights of avoidance than the actual creditor would have if that creditor were asserting invalidity on its own behalf. 11 U.S.C.A. § 544(b).

[1 Case that cites this headnote](#)

- [13] **Fraudulent Conveyances** Insolvency element of fraud

Fraudulent Conveyances Sufficiency in general

Under Utah's fraudulent-transfer statute, a creditor may void a debtor's transfer of assets if the debtor was insolvent at the time of the transfer and received less than equal value in return. Utah Code Ann. § 25-6-6 et seq.

[More cases on this issue](#)

- [14] **Bankruptcy** Governmental claims; immunity waiver

Bankruptcy Code waives the government's sovereign immunity for certain claims arising under the Code. 11 U.S.C.A. § 106(a).

- [15] **Bankruptcy** Governmental claims; immunity waiver

Bankruptcy Trustee as representative of debtor or creditors

In waiving the government's sovereign immunity “with respect to” the section of the Bankruptcy Code setting forth a bankruptcy trustee's avoidance powers as lien creditor and as successor to certain creditors and purchasers, the Code abrogates sovereign immunity only with respect to federal cause of action created by the subsection of the Code enabling a bankruptcy trustee to step into the shoes of a creditor and avoid certain transfers that would be “voidable under applicable law,” not with respect to the

underlying state-law claims that supply the “applicable law” for that federal cause of action; operating like any other waiver of sovereign immunity, the Code's abrogation provision is merely jurisdictional and does not establish any substantive rights against the government by providing a waiver of immunity that would not otherwise exist under the external source of “applicable law.” 11 U.S.C.A. §§ 106(a), 106(a)(5), 544, 544(b).

[1 Case that cites this headnote](#)

- [16] **United States** Waiver of Immunity; Consent to Suit

Waivers of sovereign immunity are jurisdictional provisions that empower courts to hear claims against the government but do not themselves typically create any new substantive rights against the government.

[More cases on this issue](#)

- [17] **United States** Necessity of waiver or consent

Sovereign immunity is jurisdictional in nature and deprives courts of the power to hear suits against the United States absent Congress's express consent.

[1 Case that cites this headnote](#)

[More cases on this issue](#)

- [18] **United States** Necessity of waiver or consent

In providing Congress's consent to hear suits against the United States, waivers of sovereign immunity function simply as “prerequisites for jurisdiction”; they do not create any new substantive rights or alter any pre-existing ones.

[More cases on this issue](#)

- [19] **United States** Wrongful levy or collection of taxes

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Outside of bankruptcy proceedings, the United States may invoke the defense of sovereign immunity to bar any lawsuit seeking to invalidate a federal tax payment under a state's fraudulent-transfer law.

[More cases on this issue](#)

[20] **United States** **Waiver of Immunity; Consent to Suit**

United States **Rights of Action Against United States or Federal Officers**

Question whether there has been a waiver of sovereign immunity is analytically distinct from question whether the source of substantive law upon which the claimant relies provides an avenue for relief.

[More cases on this issue](#)

[21] **Bankruptcy** **Trustee as representative of debtor or creditors**

In contrast to the subsection of the Bankruptcy Code enabling a bankruptcy trustee to step into the shoes of a creditor and avoid certain transfers that would be “voidable under applicable law,” the subsection permitting a trustee to invalidate certain transfers that “could have” been voided by a lien creditor, whether or not such a creditor exists, has no actual-creditor requirement. 11 U.S.C.A. §§ 544(a), 544(b).

[1 Case that cites this headnote](#)

[22] **Bankruptcy** **Trustee as representative of debtor or creditors**

Defendants in suits brought under the subsection of the Bankruptcy Code enabling a bankruptcy trustee to step into the shoes of a creditor and avoid certain transfers that would be “voidable under applicable law” are entitled to raise the same defenses against the trustee that they would have been able to raise against the relevant creditor under applicable state law. 11 U.S.C.A. § 544(b).

[23] **Bankruptcy** **Trustee as representative of debtor or creditors**

If, in a suit brought under the subsection of the Bankruptcy Code enabling a bankruptcy trustee to step into the shoes of a creditor and avoid certain transfers that would be “voidable under applicable law,” the creditor is deemed estopped to recover upon a claim, or is barred from recovery because of the running of a statute of limitations prior to the commencement of the case, the trustee is likewise estopped or barred. 11 U.S.C.A. § 544(b).

[24] **Bankruptcy** **Trustee as representative of debtor or creditors**

Bankruptcy **Judgment or order; relief**

If the “applicable” state law allows a prevailing party to recover attorney fees, then a defendant who wins a suit brought under the subsection of the Bankruptcy Code enabling a bankruptcy trustee to step into the shoes of a creditor and avoid certain transfers that would be “voidable under applicable law” can typically recover such fees from the bankruptcy estate. 11 U.S.C.A. § 544(b).

[25] **United States** **Mode and sufficiency of waiver or consent**

Congress must use unmistakable language to abrogate sovereign immunity.

[26] **United States** **Construction of waiver or consent in general**

Courts must construe any ambiguities in the scope of a waiver of sovereign immunity in favor of the sovereign.

[1 Case that cites this headnote](#)

[More cases on this issue](#)

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[27] **United States** 🏠 Construction of waiver or consent in general

General rule is that waivers of sovereign immunity are to be read narrowly.

[More cases on this issue](#)

[28] **Statutes** 🏠 Context

Statutes 🏠 Statutory scheme in general

A fundamental canon of statutory construction is that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.

[1 Case that cites this headnote](#)

[29] **Statutes** 🏠 Context

Statutes 🏠 Statutory scheme in general

Fundamental canon of statutory construction providing that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme carries particular force when construing phrases that govern conceptual relationships—like “with respect to”—whose meanings inherently depend on their surrounding context.

[2 Cases that cite this headnote](#)

[30] **United States** 🏠 Mode and sufficiency of waiver or consent

No amount of legislative history can supply a waiver of sovereign immunity that is not clearly evident from the language of the statute.

[More cases on this issue](#)

[31] **Bankruptcy** 🏠 Governmental claims; immunity waiver

Section of the Bankruptcy Code providing for abrogation of sovereign immunity as to a governmental unit is understood to provide only a limited waiver of sovereign immunity in bankruptcy cases. 11 U.S.C.A. § 106(a).

[32] **Bankruptcy** 🏠 Governmental claims; immunity waiver

At the time of its enactment, the section of the Bankruptcy Code providing for abrogation of sovereign immunity as to a governmental unit was understood by Congress to preserve a basic symmetry between bankruptcy and nonbankruptcy proceedings. 11 U.S.C.A. § 106(a).

[33] **Bankruptcy** 🏠 Governmental claims; immunity waiver

Immunity waiver contained in the section of the Bankruptcy Code providing for abrogation of sovereign immunity as to a governmental unit reaches monetary judgments entered against the government. 11 U.S.C.A. § 106(a).

[34] **Bankruptcy** 🏠 Trustee as representative of debtor or creditors

Under the Bankruptcy Code, a bankruptcy trustee may set aside certain transfers—specifically, transfers of certain liens—without identifying an actual creditor capable of invalidating those transfers under state law. 11 U.S.C.A. § 544(a).

[35] **Internal Revenue** 🏠 Liens

Federal tax law provides that tax liens held by the federal government may be invalidated under particular circumstances. 26 U.S.C.A. § 6323.

[More cases on this issue](#)

[36] **Bankruptcy** 🏠 Taxes

Bankruptcy 🏠 Trustee as representative of debtor or creditors

Bankruptcy trustee can avoid transfers of certain tax liens under the Bankruptcy Code without

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identifying an actual creditor and without needing to identify a waiver of immunity to sustain a claim under the Internal Revenue Code. 11 U.S.C.A. § 544(a); 26 U.S.C.A. § 6323.

[More cases on this issue](#)

[3 Cases that cite this headnote](#)

***843** *Syllabus* *

[37] **Bankruptcy** 📌 Governmental claims; immunity waiver

Bankruptcy Code abrogates sovereign immunity not just for the federal government, but for any “governmental unit,” which includes any state. 11 U.S.C.A. §§ 101(27), 106(a).

[1 Case that cites this headnote](#)

[38] **United States** 📌 Mode and sufficiency of waiver or consent

If Congress establishes a cause of action that—by its own explicit terms—authorizes suits against the government, then Congress need not also enact an independent waiver of sovereign immunity.

[More cases on this issue](#)

[39] **United States** 📌 Mode and sufficiency of waiver or consent

A waiver of sovereign immunity must be unmistakably clear in the language of the statute.

[1 Case that cites this headnote](#)

[More cases on this issue](#)

[40] **Federal Courts** 📌 Presentation of Questions Below or on Review; Record; Waiver

Federal Courts 📌 Briefs and oral argument

The Supreme Court would decline to address an argument that turned on readings of both state and federal law that no other court had ever considered, that respondent had not raised below, and that posed a question that had not been adequately briefed and argued before the Court.

This case concerns the powers given a bankruptcy trustee under § 544(b) of the Bankruptcy Code to set aside, or “avoid,” certain fraudulent transfers of a debtor’s assets. See 11 U.S.C. §§ 544(b)(1). Respondent is the bankruptcy trustee of a failed Utah-based business whose shareholders misappropriated \$145,000 in company funds to satisfy their personal federal tax liabilities. Respondent filed an “avoidance” suit against the United States seeking to claw back the misappropriated funds for the benefit of the bankruptcy estate. He filed the action pursuant to § 544(b), which allows a trustee to “avoid any transfer of an interest of the debtor ... that is voidable under applicable law by a creditor holding an unsecured claim.” But to prevail under § 544(b), a trustee must identify an “actual creditor” who could have voided the transaction under applicable law outside of bankruptcy proceedings. In this case, respondent invoked Utah’s fraudulent-transfer statute—which gives creditors a cause of action to invalidate certain transfers by a debtor—as the “applicable law” underlying his § 544(b) claim. The Government argued that respondent’s § 544(b) claim failed because respondent could not identify an “actual creditor” that could have voided the fraudulent transfer because sovereign immunity would bar any such Utah cause of action against the Government. The Bankruptcy Court disagreed, concluding that § 106(a) of the Bankruptcy Code—which waives the Government’s sovereign immunity “with respect to” some 59 Bankruptcy Code provisions including § 544—also waives immunity for the Utah cause of action nested within the § 544(b) claim. The District Court adopted the Bankruptcy Court’s decision and the Tenth Circuit affirmed.

Held: Section 106(a)’s sovereign-immunity waiver applies only to a § 544(b) claim itself and not to state-law claims nested within that federal claim. Pp. 848-856.

(a) This dispute turns on the interplay between § 106(a) and § 544(b) of the Bankruptcy Code. Section 106(a)(1) provides that the Government’s “sovereign immunity is abrogated ... with respect to” a list of Code provisions, including § 544.

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Respondent contends that § 106(a) also waives sovereign immunity with respect to whatever state-law cause of action a trustee might invoke as the source of “applicable law” for his or her § 544(b) claim. But that result would transform § 106(a) from a jurisdiction-creating provision into a liability-creating provision, which conflicts with the Court’s traditional understanding of sovereign-immunity waivers. As the Court’s precedents explain, “[s]overeign immunity is jurisdictional in nature” and operates to deprive courts of the power to hear suits against the United States absent Congress’s express consent. *FDIC v. Meyer*, 510 U.S. 471, 475, 114 S.Ct. 996, 127 L.Ed.2d 308. Waivers of sovereign immunity function simply as “prerequisite[s] for jurisdiction”—they do not create any new substantive rights or alter any pre-existing ones. *United States v. Mitchell*, 463 U.S. 206, 212, 103 S.Ct. 2961, 77 L.Ed.2d 580. Respondent’s attempt to leverage § 106(a)’s waiver of immunity—*i.e.*, the statute’s grant of jurisdiction—into an affirmative expansion of the trustee’s avoidance powers under § 544(b) conflicts with the Court’s understanding of sovereign-immunity waivers. Pp. 848-850.

(b) Section 106(a)’s text, context, and structure make clear that it does not operate to modify § 544(b)’s substantive requirements. Indeed, § 106(a)(5) expressly provides that “[n]othing in this section shall create any substantive claim for relief or cause of action not otherwise existing” under some other source of law. That language directly refutes respondent’s argument that § 106(a)’s sovereign-immunity waiver extends to “[b]oth the cause of action [§ 544(b) establishes] and its elements.” Brief for Respondent 18. Construing § 106(a) to modify the “elements” of a § 544(b) claim would give the trustee a substantive claim for relief against the Government that does not “otherwise exist” under § 544(b) or Utah law in direct conflict with § 106(a)(5).

Section 544’s text and structure reinforce this conclusion. Unlike § 544(b), § 544(a) has no actual-creditor requirement and thus permits a trustee to invalidate certain transfers that a lien holder could have voided “whether or not such a creditor exists.” §§ 544(a)(1), (2). This contrast reflects Congress’s deliberate choice to tie the trustee’s rights under subsection (b) to the rights of an actual creditor under “applicable law.” Eliminating the actual-creditor requirement would upend decades of practice and precedent recognizing that § 544(b) merely empowers a trustee to step into the shoes of a creditor, subject to the same limitations and defenses that would apply to that creditor outside bankruptcy.

Finally, even if the language and logic of § 544 and § 106(a) permitted respondent’s broad reading of the sovereign-immunity waiver, the Court’s precedents would still foreclose that reading. The Court’s precedents require construing sovereign-immunity waivers narrowly, with any ambiguities resolved in favor of the sovereign. See, *e.g.*, *FAA v. Cooper*, 566 U.S. 284, 291, 132 S.Ct. 1441, 182 L.Ed.2d 497. Pp. 850-852.

(c) Respondent asserts that § 106(a)(1)’s use of the phrase “with respect to” shows Congress’s intent to abrogate sovereign immunity for “all subjects that concern or regard” the listed provisions, including the meaning of “applicable law” in § 544(b). Respondent’s reliance on dictionary definitions and cases that adopt capacious readings of phrases similar to “with respect to” cannot support his argument, as those authorities all examine those terms in very different statutory contexts. Respondent’s textual argument thus flouts the “fundamental canon of statutory construction” that “the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.” *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 809, 109 S.Ct. 1500, 103 L.Ed.2d 891. This canon carries particular force when construing phrases that govern conceptual relationships—like “with respect to”—whose meanings inherently depend on their surrounding context. See, *e.g.*, *Dubin v. United States*, 599 U.S. 110, 119, 143 S.Ct. 1557, 216 L.Ed.2d 136 (noting that such phrases are “context sensitive”). As set forth above, context cuts decidedly against respondent’s broad reading of § 106(a)(1).

Respondent’s appeal to § 106(a)’s enactment history is similarly unavailing. Since its adoption in 1978, § 106 has always been understood to provide a “limited waiver of sovereign immunity in bankruptcy cases,” designed to “achieve approximately the same result that would prevail outside of bankruptcy.” S. Rep. No. 95–989, at 29; H. R. Rep. No. 95–595, at 317. Nothing in the 1994 amendments to § 106 dislodged that original understanding. And in any event, legislative history cannot supply a waiver where the language of the statute does not clearly do so. See *Department of Agriculture Rural Development Rural Housing Service v. Kirtz*, 601 U.S. 42, 49, 144 S.Ct. 457, 217 L.Ed.2d 361. Pp. 852-854.

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(d) Respondent's remaining arguments lack merit. First, the Court's interpretation does not render § 106(a)'s waiver meaningless with respect to § 544. Section 106(a) enables trustees to prevail against the Government under § 544(a), which has no actual-creditor requirement. Because federal tax law separately provides that tax liens held by the Federal Government may be invalidated under particular circumstances, see 26 U.S.C. § 6323, § 106(a) allows trustees to avoid transfers of these tax liens. Section 106(a) also grants federal courts jurisdiction to hear § 544(b) claims against state governments that have consented to being sued under their fraudulent-transfer statutes.

Second, the Court rejects respondent's argument that because § 106(a)(1) refers to § 544 as a whole (rather than by subsection), the waiver must be construed to give substantive effect to all of § 544's subsections. Many of the other 58 Bankruptcy Code provisions listed "as a whole" in § 106(a)(1) include subsections that plainly do not implicate sovereign immunity at all.

Third, respondent's reliance on *Kirtz*, 601 U.S. 42, 144 S.Ct. 457, 217 L.Ed.2d 361, to support his argument that Congress sometimes waives sovereign immunity while simultaneously establishing a new substantive right, is unavailing. *Kirtz* involved a statute that bears little resemblance—in text, structure, or operation—to § 106(a), and indeed explicitly authorized claims against the Government. Nothing in *Kirtz* suggests that courts should presume, in the absence of explicit statutory language, that Congress has waived the Government's sovereign immunity.

Finally, the Court declines respondent's invitation to affirm on alternative grounds, leaving it to the courts below to decide whether respondent may pursue these arguments on remand. Pp. 854-856.

71 F.4th 1247, reversed.

JACKSON, J., delivered the opinion of the Court, in which ROBERTS, C. J., and THOMAS, ALITO, SOTOMAYOR, KAGAN, KAVANAUGH, and BARRETT, JJ., joined. GORSUCH, J., filed a dissenting opinion.

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Opinion

Justice JACKSON delivered the opinion of the Court.

***846 [1]** The Bankruptcy Code empowers a bankruptcy trustee to set aside, or “avoid,” certain transfers of a debtor's assets in order to recover those assets for the benefit of the bankruptcy estate. This case concerns the trustee's avoidance powers under § 544(b) of the Code. Under that provision, a trustee may avoid certain transfers that would be “voidable under applicable law”—that is, voidable outside of bankruptcy proceedings. 11 U.S.C. § 544(b)(1). Trustees typically rely on state statutes to supply the “applicable law” when suing under § 544(b) to avoid a debtor's transfer of assets.

In this dispute, a trustee invoked Utah law as the basis for a § 544(b) suit seeking to claw back a debtor's federal tax payment. Ordinarily, the Federal Government's sovereign immunity would bar any suit against it under Utah law. But the Bankruptcy Code contains a sovereign-immunity waiver, § 106(a), that abrogates the Government's sovereign immunity “with respect to” § 544. § 106(a)(1). This case requires us to determine the scope of that waiver.

Specifically, we must decide whether § 106(a) abrogates sovereign immunity *only* with respect to the federal cause of action created by § 544(b) or whether it *also* abrogates sovereign immunity with respect to the underlying state-law claims that supply the “applicable law” for that federal

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cause of action. We hold that § 106(a)'s sovereign-immunity waiver applies only to the § 544(b) claim itself and not to any state-law claims nested within that federal claim. Section 106(a) is properly understood as a jurisdictional provision that empowers courts to hear § 544(b) claims against the Government to the extent such claims are otherwise available under state law; it does not alter the substantive meaning of § 544(b)'s "applicable law" clause. We therefore reverse the decision below.

I

A

[2] [3] Bankruptcy trustees have long had the power to invalidate, or "avoid," certain transfers of assets made by a debtor. These "avoidance powers" serve multiple ends. Most obviously, they help the trustee maximize the value of the bankruptcy estate by enabling the trustee to recover assets that otherwise would have been lost. The avoidance powers also help the trustee equalize the distribution of the debtor's assets among creditors by preventing the debtor from offloading assets to preferred creditors outside of the formal bankruptcy process.

[4] [5] [6] Today, the avoidance powers are codified in Chapter 5 of the Bankruptcy Code, which delineates the specific types of transfers that trustees are empowered to set aside. Section 545 of the Code, for instance, permits a trustee to avoid the transfer of certain statutory liens. Meanwhile, § 547(b) allows a trustee to invalidate transfers that the debtor made immediately before bankruptcy proceedings began. And § 548 permits a trustee to set aside certain fraudulent transfers, such as those made for the purpose of delaying or impeding the repayment of creditors.

[7] This case involves the trustee's avoidance powers under § 544(b). That provision allows a trustee to "avoid any transfer of an interest of the debtor ... that is voidable under applicable law by a creditor holding an unsecured claim." § 544(b)(1). Although the term "applicable law" can technically refer to any state or federal law outside of the Bankruptcy Code, trustees typically rely on state statutes to supply the "applicable law" for avoidance suits under § 544(b).

[8] [9] The state statutes that trustees most often invoke are known as "fraudulent transfer" laws. 5 Collier on Bankruptcy ¶544.06[2], p. 544–27 (R. Levin & H. Sommer eds., 16th ed. 2022). These laws—which generally employ the same language from State to State—aim to prevent debtors from hiding or shielding their assets from creditors. See *ibid.* (explaining that 46 States have adopted either the Uniform Fraudulent Transfer Act or its successor, the Uniform Voidable Transactions Act). To that end, most fraudulent-transfer statutes provide creditors with a cause of action to invalidate any transfer that a debtor made with the intent to defraud creditors. Creditors may also typically invoke these laws to void "constructive" fraudulent transfers—that is, transfers made without an actual intent to defraud, such as an insolvent debtor's sale or transfer of assets for something less than their equivalent value. 2 Bankruptcy Law Manual § 9:29, pp. 779–780 (5th ed. 2024).¹

[10] Notably, to show that a transfer is "voidable under applicable law," a bankruptcy trustee must "identify the actual creditor or creditors who could have set aside the transaction in question under applicable law." 5 Collier, Bankruptcy ¶544.06[1], at 544–25. "If there is no creditor against whom the transfer is voidable under the applicable law, the trustee is powerless to act." *Ibid.*

[11] [12] This "actual creditor" requirement serves as an important check on the trustee's § 544(b) powers. Absent the actual-creditor requirement, a trustee could use § 544(b) to unwind transactions that would never actually be at risk of invalidation outside of bankruptcy proceedings. The actual-creditor requirement thus mitigates the disruptive potential of a trustee's avoidance power by ensuring that the trustee *848 has "no greater rights of avoidance than the actual creditor would have if that creditor were asserting invalidity on its own behalf." *Id.*, ¶544.06[3], at 544–29.

B

This case arises from the collapse of a Utah-based transportation business called All Resort Group. The company fell into insolvency in 2013 as the result of poor management and financial malfeasance. As the company struggled financially, two of its shareholders began misappropriating company funds for their own personal use,

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including to pay off personal debts. In 2014, they transferred roughly \$145,000 in company funds to the Internal Revenue Service to satisfy their personal income-tax obligations. The company received nothing in return for paying off these shareholders' debts.

Three years later, the company filed for bankruptcy. Respondent was appointed as trustee of the bankruptcy estate. He filed this suit against the United States under § 544(b) shortly after his appointment, seeking to avoid the 2014 tax payments.

[13] Respondent invoked Utah's fraudulent-transfer statute as the source of "applicable law" for his § 544(b) claim. Like most fraudulent-transfer laws, Utah's statute allows a creditor to void a debtor's transfer of assets if the debtor was insolvent at the time of the transfer and received less than equal value in return. *Utah Code* § 25–6–6 *et seq.* (2014).²

The parties cross-moved for summary judgment in Bankruptcy Court. The Government did not contest respondent's allegation that All Resort Group was insolvent when it made the 2014 tax payments on behalf of its shareholders. Nor did it dispute that the company received nothing of value in exchange for making those payments. Instead, the Government asserted that respondent's claim failed because he could not satisfy § 544(b)'s actual-creditor requirement. Specifically, the Government argued, respondent could not identify any creditor capable of prevailing in a fraudulent-transfer suit against the Government under Utah law because, outside of bankruptcy, any such suit would be barred by sovereign immunity.

[14] The Bankruptcy Court rejected that argument and entered judgment for respondent. *In re All Resort Group, Inc.*, 617 B.R. 375, 379 (Bkrcty. Ct. D.Utah 2020). The court based its decision on § 106(a) of the Bankruptcy Code, which waives the Government's sovereign immunity for certain claims arising under the Code. *Id.*, at 386. In particular, § 106(a)(1) provides that "sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to" 59 different provisions of the Code, including § 544. § 106(a)(1).³

The Bankruptcy Court construed § 106(a) as waiving the Government's sovereign immunity not only as to the trustee's

§ 544(b) claim but also "as to the underlying state law cause of action" nested within the § 544(b) claim. 617 B.R. at 386. Accordingly, the court held that "sovereign immunity does not preclude [respondent] from satisfying the actual creditor requirement." *Id.*, at 391.

The District Court adopted the Bankruptcy Court's decision and the Tenth Circuit *849 later affirmed. 71 F.4th 1247 (2023). Like the Bankruptcy Court, the Tenth Circuit concluded that § 106(a) "expresses Congress's intent to abolish the Government's sovereign immunity in an avoidance proceeding arising under § 544(b)(1), regardless of the context in which the defense arises." *Id.*, at 1253.

The Tenth Circuit's decision reinforced a conflict among the Courts of Appeals regarding whether § 106(a) abrogates sovereign immunity with respect to a state-law claim that supplies the "applicable law" for a trustee's § 544(b) claim. We granted certiorari to resolve that conflict. See 602 U. S. —, 144 S.Ct. 2678, 219 L.Ed.2d 1297 (2024).

II

This dispute turns on the interplay between § 106(a) and § 544(b) of the Bankruptcy Code. The parties here agree that § 106(a) waives the Government's sovereign immunity with respect to the federal cause of action created by § 544(b). But respondent contends that § 106(a) goes further than that by also waiving sovereign immunity with respect to whatever state-law cause of action a trustee might invoke as the source of "applicable law" for his or her § 544(b) claim.

[15] [16] As explained below, we hold that § 106(a) does not sweep as broadly as respondent maintains. Waivers of sovereign immunity are jurisdictional provisions that empower courts to hear claims against the Government but do not themselves typically create any new substantive rights against the Government. Here, statutory text, context, and structure all demonstrate that § 106(a) fits squarely within that mold. For that reason, we conclude that § 106(a) does not alter the substantive meaning of § 544(b)'s "applicable law" clause by providing a waiver of immunity that would not otherwise exist under that external source of law.

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[17] [18] Before discussing § 106(a) itself, it is helpful to recall how waivers of sovereign immunity operate in general. As our precedents explain, “[s]overeign immunity is jurisdictional in nature” and deprives courts of the power to hear suits against the United States absent Congress’s express consent. *FDIC v. Meyer*, 510 U.S. 471, 475, 114 S.Ct. 996, 127 L.Ed.2d 308 (1994). In providing that consent, waivers of sovereign immunity function simply as “prerequisite[s] for jurisdiction”—they do not create any new substantive rights or alter any pre-existing ones. *United States v. Mitchell*, 463 U.S. 206, 212, 103 S.Ct. 2961, 77 L.Ed.2d 580 (1983).

That is precisely the role that § 106(a) plays within the Bankruptcy Code. Section 106(a)(1) provides that the Federal Government’s “sovereign immunity is abrogated ... with respect to” several dozen provisions of the Code, thereby granting courts the power to hear claims against the Government under those provisions. That includes the power to hear claims under § 544, which is among the listed provisions. At the same time, § 106(a)(5) expressly provides that “[n]othing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law.” In this way, § 106(a)’s text, read as a whole, makes clear that it operates like any other waiver of sovereign immunity: It is “merely jurisdictional” and does not establish any substantive rights against the Government. *United States v. Testan*, 424 U.S. 392, 400, 96 S.Ct. 948, 47 L.Ed.2d 114 (1976).

*850 [19] Respondent’s reading of § 106(a) departs from that conventional understanding of sovereign-immunity waivers. Under respondent’s view, § 106(a) does not simply give courts jurisdiction to hear § 544(b) claims against the Government; it also alters the substantive requirements of the claim itself. It is undisputed that, outside of bankruptcy proceedings, the United States could invoke the defense of sovereign immunity to bar any lawsuit seeking to invalidate a federal tax payment under a State’s fraudulent-transfer law. That barrier to state-law liability would ordinarily doom a trustee’s § 544(b) claim by making it impossible for the trustee to show that the tax payment at issue is “voidable under applicable law” by an actual creditor. But, respondent

contends, § 106(a) vitiates that barrier by abrogating the Government’s sovereign immunity with respect to *both* the § 544(b) claim *and* the state-law claim nested within it. As respondent puts it, “Section 106(a)’s clear waiver ‘with respect to’ section 544 applies equally to the trustee’s section 544(b) cause of action and the applicable law that provides the elements of that cause of action.” Brief for Respondent 2.

[20] Respondent’s reading of § 106(a) would thus transform that statute from a jurisdiction-creating provision into a liability-creating provision. But we have declined to read sovereign-immunity waivers in that way. Rather, we have said that the question “whether there has been a waiver of sovereign immunity” is “ ‘analytically distinct’ ” from the question “whether the source of substantive law upon which the claimant relies provides an avenue for relief.” *Meyer*, 510 U.S. at 484, 114 S.Ct. 996; see, e.g., *United States v. Navajo Nation*, 556 U.S. 287, 290, 129 S.Ct. 1547, 173 L.Ed.2d 429 (2009) (“Neither the Tucker Act nor the Indian Tucker Act creates substantive rights; they are simply jurisdictional provisions that operate to waive sovereign immunity for claims premised on other sources of law”). Respondent conflates these two questions by seeking to leverage § 106(a)’s waiver of immunity—*i.e.*, the statute’s grant of jurisdiction—into an affirmative expansion of the trustee’s avoidance powers under § 544(b).

Construing § 106(a) to modify the elements of a § 544(b) claim would thus reflect a highly unusual understanding of sovereign-immunity waivers. That alone casts doubt on respondent’s reading of § 106(a). But even if that reading did not conflict with our normal understanding of sovereign-immunity waivers, it would remain untenable as a basic matter of text and structure.

B

The text and structure of § 106 and § 544 make clear that § 106(a)’s waiver of sovereign immunity does not operate to modify § 544(b)’s substantive requirements.

As noted above, § 106(a) expressly states that it does *not* “create any substantive claim for relief or cause of action not otherwise existing” under some other source of law. § 106(a)(5). That language plainly refutes the notion that § 106(a)’s

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sovereign-immunity waiver extends to “[b]oth the cause of action [that § 544(b) establishes] and its elements.” Brief for Respondent 18. Indeed, construing § 106(a) to modify the “elements” of a § 544(b) claim would necessarily give the trustee a substantive claim for relief against the Government that does not “otherwise exist” under § 544(b) or Utah law.⁴ Section 106(a)’s text thus confirms *851 that it does not alter § 544(b)’s substantive requirements.

So, too, does the list of Bankruptcy Code provisions identified in § 106(a) itself. Notably, § 106(a) does not meaningfully alter the substantive obligations of trustees under any of the 58 other provisions that appear on the list alongside § 544. So far as we are aware, the other avoidance provisions on the list retain the same substantive elements regardless of whether the trustee is suing the Government or a private entity. Given that § 106(a) leaves the substantive elements of those avoidance provisions untouched, it would be odd to read the provision as modifying the elements of § 544(b).

[21] Section 544’s own text and structure reinforce that conclusion. Recall that § 544(b) requires a trustee to identify an actual creditor capable of voiding the transfer at issue under “applicable law.” That actual-creditor requirement—which restricts the universe of transactions a trustee can invalidate—is unique to § 544(b). Section 544’s only other subprovision—subsection (a)—conspicuously eschews any such requirement. Instead, subsection (a) permits a trustee to invalidate certain transfers that “could have” been voided by a lien creditor, “whether or not such a creditor exists.” §§ 544(a) (1), (2) (emphasis added). That contrast in structure reflects a deliberate congressional choice to tie the trustee’s rights under subsection (b) to the rights of an actual creditor under “applicable law.” We doubt that Congress meant to supplant that choice when it opted to include § 544 on the lengthy list of provisions it inserted into § 106(a).

What is more, eliminating the actual-creditor requirement would upend decades of practice and precedent. Section 544(b) was expressly “derived” from § 70e of the Bankruptcy Act of 1898, which had long been understood to give trustees the same rights as creditors under state law. *S. Rep. No. 95–989*, p. 85 (1978); *H. R. Rep. No. 95–595*, p. 370 (1977). As one widely cited lower court decision put it, § 70e “clothe[d] the trustee with no new or additional right ... over that possessed by a creditor”; it merely placed the trustee “in

the shoes of” the creditor, “subject to the same limitations and disabilities that would have beset the creditor in the prosecution of the action on his own behalf.” *Davis v. Willey*, 263 F. 588, 589 (ND Cal. 1920).

[22] [23] [24] Section 544(b) carried forward that same understanding of the trustee’s role. That is why, for example, defendants in § 544(b) suits are entitled to raise the *852 same defenses against the trustee that they would have been able to raise against the relevant creditor under applicable state law. Thus, “if the creditor is deemed estopped to recover upon a claim, or is barred from recovery because of the running of a statute of limitations prior to the commencement of the case, the trustee is likewise estopped or barred.” 5 Collier, Bankruptcy ¶544.06[3], at 544–29. Similarly, if the “applicable” state law allows a prevailing party to recover attorney’s fees, then a defendant who wins a § 544(b) suit can typically recover such fees from the bankruptcy estate. *Id.*, at 544–27. This long-settled understanding of the trustee’s § 544(b) powers—and their limits—underscores why it would be so anomalous to treat § 106(a) as expanding the trustee’s rights beyond those of an actual creditor.⁵

[25] [26] Even if the language and logic of § 544 and § 106(a) permitted respondent’s broad reading of the sovereign-immunity waiver, we note further that our precedents would still foreclose that reading. “Under long-settled law, Congress must use unmistakable language to abrogate sovereign immunity.” *Financial Oversight and Management Bd. for P. R. v. Centro de Periodismo Investigativo, Inc.*, 598 U.S. 339, 342, 143 S.Ct. 1176, 215 L.Ed.2d 321 (2023). That means that we must “construe any ambiguities in the scope of a waiver in favor of the sovereign.” *FAA v. Cooper*, 566 U.S. 284, 291, 132 S.Ct. 1441, 182 L.Ed.2d 497 (2012). Here, § 106(a)’s language unmistakably waives sovereign immunity for the federal cause of action created by § 544(b). But, for all of the reasons just given, we cannot say that it does the same for the state-law claims nested within § 544(b)’s “applicable law” clause.

III

A

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Respondent interprets § 106(a) differently. He asserts that § 106(a)(1)'s use of the phrase "with respect to" requires a broad reading of the statute's sovereign-immunity waiver, citing dictionary definitions and cases that adopt capacious readings of similar phrases. These sources, he says, evince Congress's intent to abrogate sovereign immunity for "all subjects that concern or regard" the listed provisions, including the meaning of "applicable law" in § 544(b). Brief for Respondent 16.

[27] The authorities respondent invokes, however, cannot bear the weight he foists upon them. Even setting aside that many of his authorities concern different statutory terms, they all examine those terms in very different statutory contexts. For instance, he cites our observation in *Lamar, Archer & Cofrin, LLP v. Appling*, 584 U.S. 709, 717, 138 S.Ct. 1752, 201 L.Ed.2d 102 (2018), that the "[u]se of the word 'respecting' in a legal context generally has a broadening effect." But the statute at issue in *Lamar* used the term "respecting" in a quite dissimilar setting—as part of the technical phrase "statement[s] respecting the debtor's or an insider's financial condition." § 523(a)(2)(A). Giving breadth to a discrete statutory term like "financial condition" is a far cry from expanding a sovereign-immunity waiver, especially *853 when our "general rule" is "that waivers of sovereign immunity are to be read *narrowly*." *Meyer*, 510 U.S. at 480, 114 S.Ct. 996 (emphasis added).

[28] [29] Respondent's textual argument thus flouts a "fundamental canon of statutory construction": that "the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 809, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989). That canon carries particular force when construing phrases that govern conceptual relationships—like "with respect to"—whose meanings inherently depend on their surrounding context. Cf. *Dubin v. United States*, 599 U.S. 110, 119, 143 S.Ct. 1557, 216 L.Ed.2d 136 (2023) (explaining that the phrase "[i]n relation to" is "context sensitive").

Here, context cuts decidedly against the broad reading respondent advances. As explained, construing § 106(a) to reach the elements of § 544(b) would not only run counter to our traditional understanding of sovereign-immunity waivers as purely jurisdictional, but also contravene the text and structure of § 106(a) and § 544(b), and defy our established

rule that sovereign-immunity waivers must be construed narrowly. Section 106(a)'s use of a malleable phrase like "with respect to" cannot blunt the countervailing force of those contextual considerations and interpretive principles. Cf. *Presley v. Etowah County Comm'n*, 502 U.S. 491, 504, 112 S.Ct. 820, 117 L.Ed.2d 51 (1992) (rejecting a broad reading of the phrase "'with respect to voting'" in the Voting Rights Act where doing so "would work an unconstrained expansion of its coverage").

[30] Respondent resists the force of those contextual considerations by appealing to § 106(a)'s enactment history. He emphasizes that Congress purposefully expanded the scope of § 106(a)'s immunity waiver in 1994 by adding the list of 59 specific provisions, including § 544, to the statute. But "no amount of legislative history can 'supply a waiver that is not clearly evident from the language of the statute.'" *Department of Agriculture Rural Development Rural Housing Service v. Kirtz*, 601 U.S. 42, 49, 144 S.Ct. 457, 217 L.Ed.2d 361 (2024) (quoting *FAA*, 566 U.S. at 290, 132 S.Ct. 1441). And, even if legislative history could serve that function, respondent's account of § 106(a)'s history is incomplete at best.

[31] [32] Since its adoption in 1978, § 106 has always been understood to provide only a "limited waiver of sovereign immunity in bankruptcy cases." S. Rep. No. 95–989, at 29; H. R. Rep. No. 95–595, at 317. The House and Senate Reports accompanying the 1978 legislation both expressly stated: "Though Congress has the power to waive sovereign immunity for the Federal government completely in bankruptcy cases, the policy followed here is designed to achieve approximately the *same result that would prevail outside of bankruptcy*." S. Rep. No. 95–989, at 29 (emphasis added); H. R. Rep. No. 95–595, at 317 (emphasis added). This suggests that, at the time of enactment, Congress understood the statute to preserve a basic symmetry between bankruptcy and nonbankruptcy proceedings—not to expand transferee liability within the bankruptcy system.

[33] Nothing in the 1994 amendments to § 106 dislodged that original understanding. When Congress adopted § 106(a)'s current language in 1994, it did so with the narrow aim of overturning two of this Court's decisions: *United States v. Nordic Village, Inc.*, 503 U.S. 30, 112 S.Ct. 1011, 117 L.Ed.2d 181 (1992), and *854 *Hoffman v. Connecticut Dept. of Income Maintenance*, 492 U.S. 96, 109 S.Ct.

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2818, 106 L.Ed.2d 76 (1989). Those decisions—neither of which involved § 544(b) itself—had held that § 106’s immunity waiver did not reach monetary judgments entered against the Government. The 1994 amendments served to clarify that § 106 does, in fact, “expressly provid[e] for a waiver of sovereign immunity ... with respect to monetary recoveries.” *H. R. Rep. No. 103–835, p. 42* (1994). But the amendments did not expand § 106’s scope beyond what Congress envisioned in 1978. Rather, their goal was “to make section 106 conform to the Congressional intent of the Bankruptcy Reform Act of 1978.” *Ibid.* (emphasis added).

In sum, § 106(a)’s enactment history—to the extent it plays any role here—undercuts respondent’s broad reading of § 106(a) and reaffirms what the statute’s text makes evident: that in waiving sovereign immunity “with respect to” § 544, Congress did not alter the substantive elements of § 544 itself.

B

Respondent gains slightly more traction in arguing that the Government’s reading of § 106(a) would blunt the impact of Congress’s decision to include § 544 on the list of provisions subject to § 106(a)’s immunity waiver. After all, respondent says, if sovereign immunity bars every state-law claim capable of furnishing the “applicable law” for a § 544(b) suit, then—as a practical matter—no trustee could ever win such a suit against the Government. Thus, respondent asserts, the Government’s reading of § 106(a) effectively robs the immunity waiver of any meaningful purpose with respect to § 544; it simply grants federal courts jurisdiction over a set of inherently unwinable claims.

[34] [35] [36] We are not persuaded that the Government’s reading extinguishes § 106(a)’s effect with respect to § 544. For one thing, even if § 106(a) does not enable trustees to prevail against the Government under § 544(b), they might still prevail against the Government under § 544’s other subprovision—subsection (a). As noted above, subsection (a), unlike subsection (b), does not contain an actual-creditor requirement. A trustee can therefore use subsection (a) to set aside certain transfers—specifically, transfers of certain liens—without identifying an actual creditor capable of invalidating those transfers under state law. And federal tax law separately provides that tax liens held by the

Federal Government may be invalidated under particular circumstances. See 26 U.S.C. § 6323. As a result, a trustee can avoid transfers of certain tax liens under § 544(a) without identifying an actual creditor and without needing to identify a waiver of immunity to sustain a claim under the Internal Revenue Code. By giving courts jurisdiction to hear those types of claims against the Government, then, § 106(a) serves a clear purpose “with respect to” § 544.

Respondent rejects that understanding of § 106(a), insisting that the waiver must be construed to give substantive effect to *all* of § 544’s subsections—not just subsection (a). He stresses that § 106(a)(1)’s list of provisions refers to § 544 as a whole, without demarcating any specific subsections. But the same is true of the 58 other Bankruptcy Code provisions on the list, many of which include subsections that plainly do not implicate sovereign immunity at all. Section 303, for example, appears on the list even though subsection (a) of that provision authorizes a kind of action—involuntary bankruptcy petitions—that cannot be filed against the Government. The list also includes § 106 itself, despite the obvious incongruity of applying § 106(a) to its own waiver of sovereign immunity. The sheer number of provisions on the list with subsections that cannot plausibly be the subject of an immunity waiver rebuts respondent’s strained reading of § 106(a).

[37] It is also noteworthy that, in addition to the role that § 106(a) plays with respect to § 544(a), the waiver provision serves an independent function with respect to § 544(b): It grants federal courts jurisdiction to hear § 544(b) claims brought against *state* governments. As outlined earlier, § 106(a) abrogates sovereign immunity not just for the Federal Government, but for any “governmental unit,” which includes any “State.” § 101(27). At the time Congress enacted § 106(a), a handful of States had chosen to subject themselves to potential liability under their own fraudulent-transfer statutes.⁶ Section 106(a) thus granted federal courts jurisdiction to hear § 544(b) suits against those states—jurisdiction that those courts would have otherwise lacked.

C

Respondent’s argument also lacks support in our precedent. Respondent cites our recent decision in *Kirtz*, 601 U.S. 42,

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144 S.Ct. 457, 217 L.Ed.2d 361, as evidence that Congress sometimes waives sovereign immunity while simultaneously establishing a new substantive right against the Government. But the statutory provision at issue in *Kirtz* bears little resemblance—in text, structure, or operation—to § 106(a).

[38] In *Kirtz*, we held that a provision of the Fair Credit Reporting Act that “explicitly permitted consumer claims for damages against the government” also functioned as a waiver of sovereign immunity for those claims. *Id.*, at 51, 144 S.Ct. 457. Our decision rested on the straightforward proposition that “a cause of action authorizing suit against the government may waive sovereign immunity even without a separate waiver provision.” *Id.*, at 53, 144 S.Ct. 457. That proposition is hardly controversial. If Congress establishes a cause of action that—by its own explicit terms—authorizes suits against the Government, then Congress need not also enact an independent waiver of sovereign immunity.

[39] That logic, however, has no bearing on the question at issue here: namely, whether Congress waived sovereign immunity for a *state* cause of action that does *not* explicitly authorize suits against the Government. Nothing in *Kirtz* suggests that courts should presume, in the absence of explicit language to the contrary, that Congress has waived the Federal Government's sovereign immunity for such claims. If anything, *Kirtz* counsels in the opposite direction. Our opinion there reaffirmed that “a waiver of sovereign immunity must be ‘unmistakably clear in the language of the statute.’” *Id.*, at 49, 144 S.Ct. 457. And, once again, for all of the reasons previously discussed, § 106(a) does not contain an “unmistakably clear” waiver of immunity for state-law claims nested within § 544(b)’s “applicable law” clause.

D

Finally, we decline respondent's invitation to affirm on other grounds. As an alternative basis for ruling in his favor, respondent proposes a novel reading of § 544(b) that would purportedly allow a trustee to set aside a federal tax payment without ever triggering the Federal Government's sovereign immunity. Per that reading, the trustee could satisfy the actual-creditor *856 requirement by showing that “applicable” state law would permit a creditor to void the tax payment by suing someone *other* than the United States. Respondent

claims that he can do that here because Utah law would (in theory) permit an All Resort Group creditor to void the 2014 tax payments by suing the two shareholders who orchestrated those payments, neither of whom is protected by sovereign immunity.

[40] We will not address this argument because it turns on readings of both Utah law and § 544(b) that no other court has ever considered. Furthermore, respondent failed to raise this argument below. See *Cameron v. EMW Women's Surgical Center, P. S. C.*, 595 U.S. 267, 275, 142 S.Ct. 1002, 212 L.Ed.2d 114 (2022) (“[I]f a non-jurisdictional argument was not raised below, we generally will not consider it as an alternative ground for affirmance”). Additionally, “the question [this argument] poses has not been adequately briefed and argued” here. *Granfinanciera, S. A. v. Nordberg*, 492 U.S. 33, 38, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989). We therefore leave it to the courts below to decide whether respondent may pursue this argument on remand.⁷

* * *

Section 106(a) of the Bankruptcy Code abrogates sovereign immunity for the federal cause of action created by § 544(b). It does not take the additional step of abrogating sovereign immunity for whatever state-law claim supplies the “applicable law” for a trustee's § 544(b) claim. Accordingly, the decision of the Tenth Circuit is reversed.

It is so ordered.

Justice GORSUCH, dissenting.

The Court has often warned against “ ‘confus[ing] the doctrine of sovereign immunity with the requirement that a plaintiff state a cause of action.’ ” *Pennhurst State School and Hospital v. Halderman*, 465 U.S. 89, 112, 104 S.Ct. 900, 79 L.Ed.2d 67 (1984) (quoting *Larson v. Domestic and Foreign Commerce Corp.*, 337 U.S. 682, 692–693, 69 S.Ct. 1457, 93 L.Ed. 1628 (1949)). Yet, to my eyes, the Court's decision today “suffers a like confusion.” 465 U.S. at 112, 104 S.Ct. 900.

Three statutory provisions are relevant here. First is 11 U.S.C. § 106(a)(1), which waives the government's sovereign immunity “with respect to” § 544 of the Bankruptcy Code.

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Second is § 544(b)(1), which empowers a bankruptcy trustee to invoke the rights of “a creditor holding an unsecured claim” to set aside any transfer “that is voidable under applicable law.” And third is Utah’s fraudulent-transfer statute, which here supplies the “applicable law” for purposes of § 544(b)(1). Utah Code § 25–6–203(1) (2025).¹

As I see it, those three provisions play out this way. Under the Utah statute, a transfer is “voidable” if, after a creditor’s claim arose against the debtor, the debtor (1) “made the transfer” (2) “without receiving a reasonably equivalent value in exchange,” and (3) “was insolvent at the time.” Notably, no one before us disputes that these conditions are satisfied here and a good fraudulent-transfer claim exists. *857 71 F.4th 1247, 1251 (CA10 2023). Thus, under “applicable law,” the relevant transfers are “voidable,” and the bankruptcy trustee can use § 544(b)(1) to set them aside. That remains true even though the trustee must sue the United States to void the relevant transfers, because § 106(a)(1) bars the government from raising a sovereign-immunity defense in the trustee’s action.

The Court worries that my line of thinking would “modify the elements of a § 544(b) claim.” *Ante*, at 850. More exactly, the Court observes that, if a creditor sued the government directly under Utah’s fraudulent-transfer statute, the government could interpose a successful sovereign-immunity defense, and the creditor would lose. And, the Court fears, reading § 106(a)(1) to allow a bankruptcy trustee to bring the same claim under § 544(b)(1) would impermissibly “give the trustee a substantive claim for relief against the Government that does not ‘otherwise exist.’ ” *Ante*, at 850 (quoting § 106(a)(5); alterations omitted); *ante*, at 850 – 851, n. 4 (expressing

concern that my reading would alter “a core substantive requirement of the underlying § 544(b) claim”).

It seems to me, however, that the Court conflates two different things. Whether pursued by a private creditor or a bankruptcy trustee, a good substantive claim for relief exists. No one disputes that a fraudulent transfer took place. The question before us is a distinct one: Can the federal government defeat the claim by raising the affirmative defense of sovereign immunity? With respect to a private creditor pursuing relief in state court, the answer is yes. With respect to a trustee pursuing relief in a federal bankruptcy proceeding, the answer—thanks to § 106(a)(1)—is no. Admitting that much does not “modify the elements” of any claim or “‘create any substantive claim for relief’ ” that did not “‘otherwise exist.’ ” *Ante*, at 850 – 851 (quoting § 106(a)(5); alterations omitted). It merely acknowledges that in one setting, but not another, Congress has chosen to waive an affirmative defense to an otherwise valid claim.

For these reasons, I agree with the majority of circuits to have considered the question that bankruptcy trustees may avoid fraudulent transfers to the United States under § 544(b). See 71 F.4th at 1251–1252; *In re DBSI, Inc.*, 869 F.3d 1004 (CA9 2017); *In re Yahweh Center, Inc.*, 27 F.4th 960 (CA4 2022). As the Court concludes otherwise, I respectfully dissent.

All Citations

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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 As noted above, the Bankruptcy Code contains its own fraudulent-transfer provision in § 548. Although that provision resembles most States’ fraudulent-transfer laws, its statute of limitations is only two years. § 548(a)(1). For that reason, a trustee who seeks to invalidate a fraudulent transfer that occurred more than two years

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before the bankruptcy petition was filed will ordinarily bring a § 544(b) action—instead of a § 548 action—and point to an “applicable” state law with a longer lookback period.

- 2 Utah amended and recodified its fraudulent-transfer statute after the transfer at issue here. The changes to the statute are immaterial to the question presented in this case.
- 3 The Code defines “governmental unit” to include the “United States” and any “department, agency, or instrumentality of the United States.” 11 U.S.C. § 101(27). The definition also includes any “State.” *Ibid*.
- 4 The dissent takes issue with our suggestion that respondent's reading of § 106(a) would modify the “elements” of a § 544(b) claim. But that is not just our characterization of respondent's reading—that is how respondent himself describes his position. See, *e.g.*, Brief for Respondent 27 (“Congress had no reason to waive immunity in the first place unless the waiver applied to the elements of the cause of action”); Tr. of Oral Arg. 39 (“[T]he waiver of sovereign immunity with respect to [§]544 just on its face textually applies to the elements, to the same extent grammatically, logically that it applies to the claim. You can't waive a claim without waiving the elements”). In any event, the dissent's attempt to recast § 106(a) as merely “waiv[ing] an affirmative defense”—but not altering the elements of § 544(b)—underscores the inherent tension in respondent's position. *Post*, at 856-857 (opinion of GORSUCH, J.). Nobody disputes that § 106(a) precludes the Government from raising an affirmative *jurisdictional* defense to a § 544(b) claim. But the issue in this case is whether § 106(a) also bars the Government from raising a *merits* defense to that claim. Put differently, the question here is not whether the Government can invoke sovereign immunity to prevent a court from hearing a trustee's § 544(b) claim. Rather, the question is whether § 106(a) prevents the Government from relying on sovereign immunity to demonstrate that the trustee cannot establish a core substantive requirement of the underlying § 544(b) claim—namely, that the challenged transfer is “voidable under applicable law” by an actual creditor.
- 5 Some of respondent's *amici* assert that this understanding of the trustee's powers is belied by the fact that, in certain cases, a trustee may recover more money from a fraudulent transfer than an actual creditor would be able to recover. But that exception, which derives from this Court's decision in *Moore v. Bay*, 284 U.S. 4, 52 S.Ct. 3, 76 L.Ed. 133 (1931), relates to the trustee's power to *recover* assets from an invalid transfer—not to the scope of the trustee's power to *avoid* the transfer in the first place. It is unsurprising, then, that respondent himself does not rely on *Moore* for support here.
- 6 See, *e.g.*, Ill. Comp. Stat., ch. 705, § 505/8(a) (West 1992); N. Y. Ct. Clms. Act Law Ann. § 8 (West 1989); Ohio Rev. Code Ann. § 2743.02(A) (Lexis 1989).
- 7 We express no view on the merits of this argument, and we likewise decline to address the Government's alternative arguments concerning preemption and the Appropriations Clause.
- 1 As the majority notes, recent amendments to Utah's fraudulent-transfer statute “are immaterial to the question presented.” *Ante*, at 848, n. 2.

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By Paul W. Bonapfel* and Robert Schaaf**

Do § 523(a) Exceptions to Discharge Apply to The Discharge of a Corporation in a Subchapter V Case After “Cramdown” Confirmation Under § 1191(b)?

I. Introduction

This Article considers whether the exceptions to discharge in [§ 523\(a\) of the Bankruptcy Code](#)¹ apply to the discharge that a corporation (or other entity that is not an individual, such as a limited liability company²) receives under § 1192 in a case under subchapter V of chapter 11 (enacted by the Small Business Reorganization Act of 2019 (“SBRA”)³) when “cramdown” confirmation of its plan of reorganization occurs under § 1191(b).⁴ The issue does not arise with regard to any other chapter 11 discharge.⁵

Seven bankruptcy courts and the Ninth Circuit Bankruptcy Appellate Panel have ruled that the exception of debts in § 1192(2) “of the kind specified in [§ 523\(a\)](#)” from a cramdown discharge does not apply to a corporation because [§ 523\(a\)](#) applies only to individual debts.⁶ Reversing one of the bankruptcy courts, the Fourth Circuit in *Cantwell-Cleary Co. v. Cleary Packaging, LLC* (*In re Cleary Packaging, LLC*),⁷ concluded that [§ 1192\(2\)](#) excepts the types of debts that [§ 523\(a\)](#) lists from the cramdown discharges of both individual and corporate debtors.

The debate involves the interplay between [§ 1192\(2\)](#) and [§ 523\(a\)](#).

[Section 1192\(2\)](#) states that a cramdown discharge does not except any debt “of the kind specified” in [§ 523\(a\)](#).⁸ Because [§ 1192\(2\)](#) does not limit applicability of the exceptions to individuals, the provision indicates that the [§ 523\(a\)](#) exceptions apply to all subchapter V debtors after cramdown confirmation, including corporations.

The language of [§ 523\(a\)](#), however, leads to a different conclusion. As amended by SBRA in connection with enactment of subchapter V and the [§ 1192](#) discharge,⁹ the preamble to [§ 523\(a\)](#) reads in pertinent part: “A discharge under [section ... 1192](#) ... does not discharge an *individual* debtor from any debt” that [§ 523\(a\)](#) lists.¹⁰ The implication of this language is that [§ 1192\(2\)](#)’s reference to debts “of the kind specified” in [§ 523\(a\)](#) includes only debts that [§ 523\(a\)](#) excepts, which are debts of individuals.

In addition to the text of the two statutes, the debate involves analysis of the context of the statutes, chapter 11 policy, and legislative history.

Examination of the issue begins in Part II with a summary of subchapter V and how it changes some provisions of chapter 11 to facilitate the reorganization of smaller businesses. Part III traces the development of the discharge of corporations and

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exceptions to it in reorganization cases and discusses the derivation of the subchapter V discharge provisions. Part IV explains the rulings of the bankruptcy courts and the Fourth Circuit. Part V analyzes the competing interpretations and the reasons advanced to support them. Part VI explains why the conclusion of the bankruptcy courts that § 523(a) exceptions do not apply to a § 1192 discharge of a corporation after cramdown confirmation under § 1191(b) is the better one.

II. How Subchapter V Addresses Reorganization of Smaller Businesses

A. The Purpose of Subchapter V

In practice, confirmation and administrative provisions applicable in a traditional chapter 11 case make it burdensome or unworkable for smaller businesses.¹¹ Provisions in chapter 11 that govern a “small business case” do not adequately address the problems and impose additional problems for a smaller business debtor.¹²

Congress enacted the Small Business Reorganization Act of 2019 (the “SBRA”)¹³ to create subchapter V to address the problems. Subchapter V’s purpose is “to streamline the process by which smaller businesses reorganize and rehabilitate their financial affairs.”¹⁴ A sponsor of the legislation stated that it allows smaller business debtors “to file bankruptcy in a timely, cost-effective manner, and hopefully allows them to remain in business,” which “not only benefits the owners, but employees, suppliers, customers, and others who rely on that business.”¹⁵

SBRA enacted a new subchapter V of chapter 11 of the Bankruptcy Code, codified as 11 U.S.C.A. §§ 1181 to 1195, and made conforming amendments to several sections of the Bankruptcy Code.¹⁶ Subchapter V applies to an eligible debtor who elects its application¹⁷ as an alternative to proceeding in a traditional or small business chapter 11 case.¹⁸

A debtor is eligible for subchapter V if: (1) it is engaged in “commercial or business activities;” (2) the aggregate of its noncontingent and liquidated secured and unsecured debts does not exceed \$7,500,000; and (3) not less than 50 percent of the debts arose from the debtor’s commercial or business activities, with some exceptions.¹⁹

In pursuit of SBRA’s objectives, subchapter V modifies procedures for case administration and, critically, the requirements for cramdown confirmation.

B. Changes in Procedures to Streamline Subchapter V Case Administration

Subchapter V changes a number of burdensome administrative requirements of a traditional or small business case to put a subchapter V case on a “fast track” with early judicial involvement and independent, fiduciary supervision of the debtor, who remains in possession of assets and control of the business,²⁰ by a subchapter V trustee with oversight and monitoring duties and the specific duty to facilitate a consensual plan.²¹ No creditor’s committee is appointed unless the court orders otherwise,²² and the debtor is not required to pay quarterly U.S. Trustee fees.²³

The Subchapter V debtor must file a plan within 90 days of the order for relief, unless the court extends the time based on “circumstances for which the debtor should not justly be held accountable.”²⁴ Subchapter V reduces administrative costs by eliminating the requirement of a disclosure statement unless the court orders otherwise.²⁵ The plan itself must contain essential information that creditors need: a brief history of the debtor’s business operations, a liquidation analysis, and projections with respect to the ability of the debtor to make payments under the plan.²⁶

Within 60 days after the order for relief, the court must conduct a status conference.²⁷ The debtor must file a report not less than 14 days before the status conference that “details the efforts the debtor has undertaken and will undertake to attain a consensual plan of reorganization.”²⁸

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Collectively, these provisions streamline and expedite the case while providing safeguards to protect the interests of creditors. Significantly, expedition of the case helps to reduce administrative expenses, especially professional fees. As long as a case is pending, the trustee and attorneys for the debtor are accruing fees; shortening the case reduces them.

C. Changes in Cramdown Confirmation Requirements in Subchapter V to Facilitate Reorganization of a Smaller Business

Subchapter V also eliminates obstacles to confirmation that exist in a traditional or small business chapter 11 case. The critical changes are (1) elimination of the requirement that at least one impaired class of creditors accept the plan and the “absolute priority rule” as conditions for cramdown confirmation and (2) the addition of requirements designed to protect creditors.

Subchapter V does not change the requirements for confirmation of a corporation's plan under [§ 1129\(a\)](#)²⁹ if all impaired classes of creditors accept it.³⁰ A smaller business debtor, however, often cannot obtain acceptance of all impaired classes.

A typical plan in the case of a smaller business provides for one or more classes of secured creditors (often a major lender with a security interest in substantially all of the debtor's assets and other creditors with a security interest in specific assets such as equipment or vehicles) and a class of general unsecured creditors.

Because each secured creditor is ordinarily in a separate class, the requirement that all impaired classes accept the plan is not met if any secured creditor does not accept the plan.

Acceptance by the unsecured class is also problematic. General unsecured creditors in smaller cases often do not participate in a chapter 11 case beyond, possibly, filing a proof of claim, and they frequently do not vote. Further, a major secured lender may have a deficiency claim that is large enough to prevent acceptance by the unsecured class (i.e., more than one-third of the total amount of unsecured claims that vote) if it rejects the plan.

If one or more impaired classes does not accept the plan, the court may nevertheless confirm it if the plan meets the applicable requirements for cramdown confirmation. In a traditional or small business case, [§ 1129\(b\)](#) permits confirmation despite its rejection by one or more impaired classes if the plan (1) otherwise meets the requirements of [§ 1129\(a\)](#) and (2) does not “discriminate unfairly” and is “fair and equitable” with regard to the rejecting classes.

In a subchapter V case, [§ 1191\(b\)](#) similarly permits cramdown confirmation, but it makes two changes that eliminate obstacles to confirmation that are often insurmountable for a smaller debtor in a traditional or small business case and adds two others that protect creditors.

1. Elimination of requirement of acceptance by one impaired class for cramdown confirmation

In traditional and small business cases, cramdown confirmation requires that at least one impaired class accept the plan.³¹ Smaller debtors face significant problems in overcoming this hurdle, usually for one of two reasons.

First, when a primary secured lender is undersecured and has a substantial deficiency claim that is an unsecured claim in addition to its secured claim,³² the unsecured deficiency claim may permit the lender to control the vote of the unsecured class. On the other hand, if the primary lender has no unsecured claim, creditor apathy may result in no votes at all in the unsecured class. Alternatively, creditor apathy results in rejection of the plan by the unsecured class because creditors unhappy with the debtor vote to reject it and others do not vote.

Subchapter V eliminates this requirement.³³

2. Elimination of the “absolute priority rule” and addition of creditor protections

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A second change in the subchapter V cramdown requirements is elimination of the so-called “absolute priority rule.” Subchapter V accompanies elimination of the absolute priority rule with two additional requirements that protect creditors. One is the requirement that the debtor commit projected disposable income to the plan.³⁴ The other imposes an enhanced feasibility requirement and a requirement of appropriate remedies if the debtor does not make payments under the plan.³⁵

The “absolute priority rule,” an uncodified, judicially created doctrine developed in federal receivership cases and cases under the reorganization provisions of the Bankruptcy Act,³⁶ is codified as the “fair and equitable” requirement for cramdown confirmation in a traditional or small business case.³⁷ When a class of unsecured claims rejects the plan,³⁸ the absolute priority rule prohibits the debtor's owners from retaining their ownership³⁹ unless they receive full payment.⁴⁰

The judicially developed absolute priority rule was subject to a “new value exception.” It is not clear whether the new value exception still exists after codification of the absolute priority rule that does not expressly state it.⁴¹ If the new value exception is available, it permits the retention by existing owners of their interests in the reorganized debtor without full payment to a dissenting class if they contribute “new value” that is (1) in money or money's worth; (2) reasonably equivalent to the value of the new interest; and (3) necessary to the success of the reorganization.⁴² Many courts include a requirement that the new contribution be substantial.⁴³ In *Bank of North America National Trust and Savings Association v. 203 North LaSalle Street Partnership*,⁴⁴ the Supreme Court ruled that the new value exception, if it exists, requires some form of a “market test” to determine the adequacy of the new value, such as competitive bidding or a competing plan.⁴⁵

The absolute priority rule in a traditional or small business case presents significant obstacles for a smaller debtor. As the beginning of this Section discusses, the unsecured class in the case of a smaller business often does not accept the plan, either because an undersecured primary lender controls the class or creditor apathy results in the lack of sufficient votes for acceptance. When this occurs, the absolute priority rule prevents the debtor's owners from retaining an ownership interest unless the new value exception is available or the plan provides for payment of the unsecured claims in full. Full payment is not usually a feasible option.

Satisfaction of the new value exception requires that the debtor convince the court that the exception exists and that the plan complies with it. Potential issues are whether the owners are in a position to provide new value, whether what the owners can provide is necessary for the reorganization, and potentially whether it is “substantial.” Establishing the new value exception may require extensive litigation that the debtor may not be able to afford and may lose. Furthermore, the “marketing” requirement may be complex and its outcome uncertain.

The critical objective of a closely held corporation in a chapter 11 case is continued ownership and operation of the business by its owners. Indeed, in most cases it is likely that the business will not continue if its existing managers cannot retain their ownership.⁴⁶ The difficulties and uncertainties of the absolute priority rule may discourage a smaller business from seeking to reorganize, resulting in its liquidation. When the absolute priority rule applies to prevent continued ownership, liquidation is also the most likely result.

Subchapter V addresses these problems with new cramdown provisions that eliminate the absolute priority rule. It makes the cramdown provisions in § 1129(b) that govern traditional and small business cases inapplicable in a subchapter V case.⁴⁷ Instead, § 1191(b) states the requirements for cramdown confirmation.

Section 1191(b) permits cramdown confirmation if the plan does not discriminate unfairly and is “fair and equitable,” but § 1191(c) states a “rule of construction” for determination of whether a plan is “fair and equitable” that does not include the absolute priority rule.⁴⁸ Instead, § 1191(c)(2) imposes two requirements for the plan to be “fair and equitable” that protect the interests of creditors.

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First, the plan must provide for the debtor to apply all of its “projected disposable income” for three years, or such longer time not to exceed five years as the court may fix, to make payments under the plan⁴⁹ or, alternatively, to pay the value of that projected disposable income.⁵⁰ The language tracks the projected disposable income requirement in chapter 12 cases.⁵¹

Second, the court must find that the debtor will be able to make all payments under the plan or that there is a reasonable likelihood that the debtor will make payments under the plan.⁵² If payment is only reasonably likely, the plan must provide “appropriate remedies” to protect creditors if the debtor does not make plan payments.⁵³

The subchapter V cramdown confirmation provisions thus provide a smaller business the opportunity to reorganize and remain in business, despite opposition from creditors, if it devotes its projected disposable income to make payments under the plan *and* it can demonstrate a reasonable likelihood that its plan will work. The projected disposable income requirement and the enhanced feasibility standard provide significant protections for creditors.

D. How Subchapter V Is Working

Available data indicates that subchapter V is working as intended to permit smaller businesses to reorganize successfully.

Based on an empirical study, Bankruptcy Judge Michelle Harner (and former bankruptcy professor) and her staff concluded:⁵⁴

Overall, subchapter V appears to be working as intended. Small businesses are using the subchapter with some regularity. The businesses also are, for the most part, confirming reorganization plans at a relatively high rate in a relatively short period of time. Although more data is needed to fully understand the impact of invoking the subchapter on both the short- and longer-term prospects of financially distressed small businesses, the initial results are promising. Small businesses appear now to have a restructuring tool that is both affordable and effective for addressing their financial needs.

The survey shows that confirmation occurred in more than half of all the cases and in over 62 percent of those that were not dismissed.⁵⁵

The results are consistent with data compiled by the United States Trustee Program with regard to subchapter V cases, which shows confirmation in approximately 58 percent of the cases.⁵⁶ The report notes that, compared to non-subchapter V cases historically, subchapter V cases have “double the percentage of confirmed plans and half the percentage of dismissals, as well as a shorter time to confirmation or dismissal.”⁵⁷

Anecdotal evidence indicates that most lawyers and judges agree that subchapter V is working well.⁵⁸

III. The Development of Exceptions to Discharge in Corporate Cases

In amending a comprehensive statute like the Bankruptcy Code, Congress does not write on a clean slate.⁵⁹ Congress elected to provide for the reorganization of smaller businesses by modifying existing rules in chapter 11 cases. Subchapter V's provision for exceptions to discharge in § 1192 is modelled on the chapter 12 discharge provisions in § 1228.

This Part examines the slate on which Congress wrote the provision in § 1192(2) for the exception of debts in § 523(a) to a cramdown discharge of a corporation under § 1191(b): the law of exceptions to the discharge of a corporation in chapter 11 and 12 cases. The discussion requires consideration of exceptions to discharge under the previous reorganization provisions of the

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Bankruptcy Act of 1898⁶⁰ (chapters X, XI, and XII), as amended,⁶¹ which chapter 11 supplanted as part of the comprehensive revision of the bankruptcy laws by the Bankruptcy Reform Act of 1978⁶² that enacted the Bankruptcy Code.

A. Exceptions to Discharge Under the Bankruptcy Act of 1898

The Bankruptcy Act of 1898 was the first bankruptcy legislation that generally permitted an individual to file a voluntary bankruptcy case and made a discharge generally available without requiring consent by a percentage of creditors and a minimum distribution to creditors.⁶³ Section 17 of the Bankruptcy Act excepted a few debts from discharge,⁶⁴ which later legislation expanded.⁶⁵

Most business corporations could be adjudged an involuntary bankrupt,⁶⁶ but a corporation could not file a voluntary bankruptcy petition⁶⁷ until an amendment in 1910 made corporations eligible for bankruptcy relief.⁶⁸ A corporation received a discharge, but the discharge had little, if any, effect because bankruptcy resulted in liquidation of its assets and the Bankruptcy Act had no reorganization provisions.

B. Exceptions to Discharge Under Chapters X, XI, XII, and XIII Under the Chandler Act Amendments

The Great Depression beginning with the Wall Street crash in 1929 prompted several reorganization provisions, beginning in 1933, some of which (regarding farm bankruptcies) the Supreme Court invalidated as unconstitutional.⁶⁹ In 1938, the Chandler Act⁷⁰ made substantial revisions to the Bankruptcy Act of 1898 that included the enactment of the reorganization provisions of chapters X, XI, XII, and XIII⁷¹ that governed reorganizations until passage of the Bankruptcy Reform Act of 1978.⁷² The Chandler Act also amended other provisions of the Bankruptcy Act that continued to govern so-called “straight” bankruptcy cases that involved the liquidation of assets, the discharge of the debtor, and exceptions to it.

Chapter X governed corporate reorganizations;⁷³ individuals and unincorporated entities were not eligible.⁷⁴ Section 228 provided for the discharge of the debtor in a final decree entered upon consummation of the plan.⁷⁵ It did not provide for any exceptions to the discharge other than for taxes owed to the United States or a state within one year before the filing of the case that had not been assessed prior to confirmation or that arose postpetition.⁷⁶ The limited exception gave effect to the priority status of such tax claims in light of the fact that a taxing authority might not be able to determine the debtor's accrued tax liability quickly enough to assert its claim.⁷⁷

Chapter XI⁷⁸ permitted corporations and individuals to propose a plan for “the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms.”⁷⁹ Confirmation of a plan of arrangement resulted in the discharge of unsecured debts and liabilities, but the discharge excluded debts that were not dischargeable under § 17 of the Bankruptcy Act.⁸⁰ Moreover, chapter XI provided that the court could not confirm a plan if the debtor had been “guilty of any of the acts or failed to perform any of the duties” that would bar a discharge.⁸¹

Chapter XII⁸² permitted an arrangement if its primary purpose was the alteration or modification of rights of creditors secured by real property,⁸³ but a plan could also deal with unsecured claims.⁸⁴ A corporation could not be a chapter XII debtor.⁸⁵ Confirmation resulted in a discharge of all debts and liabilities except those excepted under § 17.⁸⁶ As in chapter XI cases, conduct that would bar a discharge prevented confirmation of a chapter XII plan.⁸⁷

Chapter XIII⁸⁸ applied only to individuals whose principal income was derived from wages, salary, or commissions.⁸⁹ It permitted a plan to deal with secured and unsecured claims.⁹⁰ Upon completion of plan payments,⁹¹ or if the debtor after three years had not completed payments due to circumstances for which the debtor could not justly be held accountable,⁹² the

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debtor received a discharge, excluding debts of creditors who had not accepted the plan that were not dischargeable under § 17. Confirmation was not permissible if the debtor engaged in conduct that would bar a discharge.⁹³

C. Exceptions to Discharge Under the Bankruptcy Code

The Bankruptcy Reform Act of 1978⁹⁴ enacted the Bankruptcy Code as a comprehensive revision of the bankruptcy laws. It replaced the separate reorganization provisions in chapters X, XI, and XII with a single chapter 11 available to both corporations and individuals and replaced chapter XIII with chapter 13.⁹⁵ It enacted chapter 7 to govern liquidation cases, providing for the discharge of debts of individuals in § 727(a),⁹⁶ subject to objections, and for exceptions of certain debts from discharge in § 523(a).⁹⁷

1. Exceptions to discharge in chapter 11 cases

At the time of enactment of the Bankruptcy Code in 1978, chapter XI had become the dominant reorganization vehicle.⁹⁸ Among other things, chapter X was unattractive for a debtor because, if its debts exceeded \$250,000, it required the appointment of a trustee, displacing the debtor from possession.⁹⁹

The discharge provisions in chapter XI could prevent reorganization under chapter XI in some cases. In a careful analysis, Professor Ralph Brubaker explained:¹⁰⁰

The corporate discharge exceptions in chapter XI—particularly the discharge exception for fraud debts—posed a substantial impediment to the ability of certain debtors to reorganize under that chapter. Of course, cases precipitated by massive fraud (where the debtor's fraud liability could easily exceed the going concern value of the debtor's business) could not be successfully prosecuted under chapter XI, as the non-dischargeability of fraud debt would preclude any attempt to even address the source of the business's financial distress. Even more significantly, though, the presence of the discharge exceptions supplied, to any creditor who could assert colorable allegations of fraud, a credible threat to “opt out” of the chapter XI restructuring, in an attempt to receive a greater recovery than other creditors. Consequently, the chapter XI discharge exceptions invited holdout creditor problems of the sort that plague non-bankruptcy workouts and that are the very impetus for a federal bankruptcy reorganization process (that can fully bind dissenters to a restructuring plan).

When Congress enacted chapter 11 in 1978 to replace chapters X, XI, and XII as part of the Bankruptcy Reform Act of 1978, it chose the chapter X approach to exceptions to discharge. The new chapter 11 provided for a corporation to receive a discharge under § 1141(d)(1) upon confirmation of a plan with no exceptions if the corporation remained in business.¹⁰¹ If all or substantially all of a corporation's assets are liquidated and it does not engage in business after consummation of the plan, section 1141(d)(3) denies a discharge.¹⁰²

The legislation accomplished the corporate discharge without exceptions in the preamble to § 523(a). Section 523(a) states that a discharge under § 1141 “does not discharge *an individual debtor*” from any of the debts that it lists.¹⁰³ Thus, although § 523(a), as part of chapter 5 of the Bankruptcy Code, applies in chapter 11 cases,¹⁰⁴ its application is limited to the chapter 11 discharge of an individual. Section 1141(d)(2) confirms that the chapter 11 discharge of an individual is subject to the § 523(a) exceptions.¹⁰⁵

The question of exceptions to a corporation's chapter 11 discharge received explicit attention during the drafting process and reflected the fact that all proponents of competing bills to reform the bankruptcy laws proposed an exceptionless discharge for corporations in chapter 11 cases.

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Based on legislative history, the provisions of the competing proposals, and the views of their proponents, Professor Brubaker concluded: ¹⁰⁶

In the drafting of the Bankruptcy Code, with the resulting consolidation of reorganization provisions into a unitary reorganization process, the differing scope of the corporate discharge as between chapters X and XI received careful scrutiny. ¹⁰⁷ And the decision to enact a corporate discharge even *more* comprehensive than that available under chapter X ¹⁰⁸ was informed by the chapter XI experience ¹⁰⁹ and the considered judgment that *any* corporate discharge exception “would leave an undesirable uncertainty surrounding reorganizations that is unacceptable.” ¹¹⁰

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) ¹¹¹ enacted § 1141(d)(6) to except two kinds of debts from the chapter 11 discharge of a corporation. Subparagraph (A) excepts debts “of a kind specified” in § 523(a)(2)(A) or (B) owed to a domestic governmental unit and debts owed to a person as the result of an action under the False Claims Act ¹¹² or similar state statute. Subparagraph (B) is for a tax or customs duty with respect to which the debtor made a fraudulent return or that the debtor willfully attempted to evade or defeat. ¹¹³ (Such debts also are excepted from the discharge of an individual under § 523(a). ¹¹⁴)

2. Exceptions to discharge in chapter 13 cases

Chapter 13 of the Bankruptcy Code, as originally enacted by the Bankruptcy Reform Act of 1978 to replace chapter XIII, ¹¹⁵ significantly expanded the chapter 13 discharge. Corporations are not eligible for chapter 13. ¹¹⁶ The chapter 13 discharge provisions are relevant nonetheless to the analysis of exceptions to discharge of a corporation in a subchapter V case after cramdown confirmation because the later-enacted chapter 12 (for which corporations are eligible ¹¹⁷) used language from the chapter 13 discharge provisions, and the chapter 12 provisions, in turn, provided the model for the subchapter V exceptions to a cramdown discharge in § 1192.

Chapter 13 provides for two types of discharges. Section 1328(a) provides for a discharge when the debtor completes payments under the plan and is sometimes called a “completion discharge.” ¹¹⁸ Section 1328(b) provides for a so-called “hardship discharge.” A debtor who has not completed all plan payments may receive a hardship discharge under certain conditions if the failure to complete payments is “due to circumstances for which the debtor should not justly be held accountable.” ¹¹⁹

As originally enacted, the completion discharge of § 1328(a) excepted only one type of debt listed in § 523(a) from discharge—obligations for alimony and other support in § 523(a)(5). It was, therefore, called a “superdischarge” because all other debts listed in § 523(a) were discharged. ¹²⁰ Later legislation excepted additional debts from the § 1328(a) discharge, so it is not as “super” as it once was. ¹²¹ If a debtor receives a § 1328(b) hardship discharge, however, any debt excepted under § 523(a) is excepted from it. ¹²²

As in chapter 11 cases, the preamble to § 523(a) gives operative effect to the more expansive completion discharge of § 1328(a) and to application of the exceptions to a hardship discharge under § 1328(b). The list in the preamble of the types of discharges to which it applies does not include § 1328(a) (so that the § 523(a) exceptions do not apply) but does list § 1328(b) (so that they do).

Both types of chapter 13 discharges also except any debt that is provided for under § 1322(b)(5). ¹²³ Section 1322(b)(5) permits a plan to provide for the cure of defaults and maintenance of postpetition payments when the last payment on the claim is due after completion of the plan. ¹²⁴ Its usual application permits a debtor to reinstate the maturity of a long-term residential mortgage through payment of a prepetition arrearage under the plan and the resumption of regular postpetition installment

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payments.¹²⁵ Because the debtor has a continuing obligation to make payments on such debts after completion of plan payments and discharge, such debts are excepted from discharge.

3. Exceptions to discharge in chapter 12 cases

In 1986, Congress enacted chapter 12 as a temporary provision for the reorganization of debts of a family farmer.¹²⁶ The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) permanently enacted chapter 12, expanded it to make a family fisherman eligible for chapter 12,¹²⁷ and made certain other amendments.¹²⁸ BAPCPA made no changes to the discharge provisions in the original legislation. Corporations as well as individuals who meet the eligibility requirements are eligible for chapter 12.¹²⁹

Congress considered competing proposals to address the reorganization of family farmers.¹³⁰ On June 24, 1985, the House passed H.R. 2211, which provided for the amendment of chapter 13 to permit a family farmer to be a chapter 13 debtor if its debts did not exceed \$1,000,000. The term “family farmer” included a corporation if it was not publicly traded and more than one half of the value of its equity securities was owned by one family or by relatives of the members of the family. H.R. 2211 amended § 1322(b)(2), which prohibits the modification of a mortgage on the debtor's principal residence, to permit modification of the residence of a family farmer if it was located on or within a reasonable proximity of the farming operation. It also amended § 1322(c) to permit a family farmer's plan to provide for payments for ten years instead of five.¹³¹ H.R. 2211 did not alter chapter 13's discharge provisions.

Subcommittees of the Senate Judiciary Committee held hearings on H.R. 2211 at which witnesses opposed amendment of chapter 13 to include family farmers as proposed because the amendments did not adequately address farmers' financial problems and did not treat farm lenders fairly. The testimony indicates that a primary concern was applicability of the chapter 13 “superdischarge” in the case of a family farmer.¹³²

The Senate passed H.R. 2211 on May 8, 1986, but replaced everything after the enacting clause with a combination of the provisions of S.B. 2249, which provided for the temporary enactment of a new chapter 12 for the reorganization of debts of family farmers, and other bills dealing with the United States Trustee, new bankruptcy judges, and technical amendments to the Bankruptcy Code.¹³³

The farm reorganization legislation that emerged from the conference committee provided for a new chapter 12 for individuals and family-owned corporations with a debt limit of \$1,500,000. Although chapter 12 was enacted as a separate chapter, it used chapter 13 as a model, providing for the appointment of a trustee to assist the court while the debtor remains in possession of property of the estate and containing plan and confirmation requirements similar to those in chapter 13. Chapter 12, unlike chapter 13, does not prohibit modification of a mortgage on the debtor's principal residence.

Both chambers passed the conference report¹³⁴ and President Reagan signed the bill on October 27, 1986.

Like chapter 13, chapter 12 has two provisions for discharge. Specifically, § 1228(a) provides for a discharge upon completion of plan payments, and § 1228(b) provides for a hardship discharge.¹³⁵

Unlike chapter 13, however, the exceptions to discharge in a chapter 12 case are the same regardless of whether the debtor receives a completion discharge after making all plan payments or a hardship discharge because the debtor failed to make all plan payments due to “circumstances for which the debtor should not justly be held accountable.” Both chapter 12 discharges are subject to the same exceptions as a chapter 13 hardship discharge and have the same language as the chapter 13 hardship discharge.¹³⁶ Thus, any chapter 12 discharge does not discharge any debt “of a kind” specified in § 523(a), with one exception, added in 2017, that provides for the discharge of certain taxes otherwise excepted under § 523(a).¹³⁷ Further, like both types of chapter 13 discharges, both chapter 12 discharges do not except long-term debts when the plan provides that the final payment is due after the final plan payment.¹³⁸

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The original enactment of chapter 12 was accompanied by a conforming amendment to § 523(a) to add both chapter 12 discharges (§ 1228(a) and § 1228(b)) to the list of discharges in its preamble.¹³⁹ Thus, § 523(a) states that a discharge under § 1228(a) or § 1228(b) “does not discharge an *individual debtor*” from any of the debts it lists.¹⁴⁰

The language in §§ 1228(a) and (b) excepting debts of the kind specified in § 523(a) make it clear that the § 523(a) exceptions apply to the discharge of an individual debtor—unlike the chapter 13 “superdischarge” but similar to the chapter 13 hardship discharge. The preamble of § 523(a) as contemporaneously amended, however, states that chapter 12 does not discharge the debts of an individual that § 523(a) lists. As Bankruptcy Judge A. Thomas Small observed in a thorough explanation of chapter 12 shortly after its enactment, “It is not clear whether debts of the kind specified in § 523(a) include corporate and partnership debts.”¹⁴¹

A section-by-section analysis of chapter 12 as enacted by the Senate is the only legislative history that addresses its discharge provisions. It stated: “The discharge is not as broad as that in chapter 13 (§ 1328) and is the same discharge that the debtor would receive in chapter 11 (§ 1141(d)).”¹⁴² Other legislative history of chapter 12—consisting of the Report of the House Judiciary with regard to H.R. 2211 (providing for amendments to chapter 13 to deal with farm reorganization),¹⁴³ the conference committee report,¹⁴⁴ and floor statements in the House¹⁴⁵ and Senate¹⁴⁶—does not mention discharge or exceptions to discharge at all.

In his analysis, Judge Small noted that, although exceptions to discharge in chapter 11 cases apply to individual debtors and not to corporations, the chapter 11 language is “far more explicit” than the chapter 12 provisions in that § 1141(d)(2) states that the exceptions to discharge apply to an individual's discharge.¹⁴⁷ Judge Small stated that the failure to employ similarly explicit language in the chapter 12 provisions “suggests that Congress intended the § 523(a) exceptions to discharge be equally applicable to individual, corporate, and partnership debtors under chapter 12.”¹⁴⁸ Two bankruptcy judges later reached that result.¹⁴⁹ No appellate court considered the issue.

D. Exceptions to discharge in subchapter V cases

Fifty-three years after enactment of chapter 12, Congress used the language and structure of the chapter 12 exceptions to discharge to state the exceptions to a discharge after cramdown confirmation in a subchapter V case in § 1192.

Like the chapter 12 discharges, § 1192(1) excepts obligations on long-term debts where payments extend beyond the term of the plan.¹⁵⁰ Section 1192(2) uses identical language to the chapter 12 discharge provisions to except debts “of the kind specified” in § 523(a) from the cramdown discharge.¹⁵¹ Finally, the Small Business Reorganization Act of 2019 that enacted subchapter V amended the preamble of § 523(a)¹⁵² in exactly the same way Congress amended the preamble in the original chapter 12 legislation. Both added the new discharge provision (§ 1192 in the subchapter V legislation, §§ 1228(a) and (b) in the chapter 12 legislation) to the list of discharges. Thus, the preamble to § 523(a) states that a discharge under § 1192 does not discharge any *individual* debtor from the debts that § 523(a) specifies.

The use of chapter 12's discharge provisions in § 1192(2) and the same type of amendment to the preamble of § 523(a) raise the same question as the chapter 12 legislation for the same textual reasons: do the discharge exceptions in § 523(a) apply to the discharge of a corporation after cramdown confirmation?

Subchapter V's legislative history consists of the Report of the House Judiciary Committee.¹⁵³ The only mention of exceptions to discharge in the report is that the § 1192 discharge excepts debts on which the last payment is due after the commitment period under the plan and “any debt that is otherwise nondischargeable.”¹⁵⁴ The use of the words “otherwise nondischargeable” logically refers to § 523(a), which applies only to debts of individuals.¹⁵⁵

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Commentators¹⁵⁶ and courts have disagreed about whether the § 523(a) exceptions are applicable to the discharge of a corporation after cramdown confirmation. The next Part examines the competing rulings.

IV. Competing Judicial Interpretations of Applicability of § 523(a) Exceptions After Cramdown Discharge

Whether the § 523(a) exceptions apply to the discharge of a corporation in a subchapter V case after cramdown discharge involves two statutory provisions.

The first is § 1192(2). When discharge occurs after cramdown confirmation, § 1192(2) excepts from discharge debts “of the kind specified” in § 523(a). It makes no distinction based on whether the debtor is an individual or corporation. Standing alone, therefore, the language states that the § 523(a) exceptions apply to discharges of a corporation.

The second provision is the preamble to § 523(a), which leads to a different conclusion. As amended by the Small Business Reorganization Act of 2019,¹⁵⁷ the preamble to § 523(a) is:

A discharge under section 727, 1141, 1192, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—[defined in paragraphs (1) through (19) of § 523(a)].

SBRA added the italicized “1192” to the list of other sections, which are sections under which a discharge is granted in chapter 7, 11, 12, and 13 cases.

As amended, therefore, § 523(a) states: “A discharge under section ... 1192 ... does not discharge an individual debtor from any debt” that § 523(a) lists. Giving effect to this language, § 1192(2)’s reference to debts “of the kind specified” in § 523(a) includes only debts that § 523(a) excepts, which are only debts of individuals. In other words, although § 1192(2) states discharge rules for all debtors without regard to whether they are individuals or not, its reference to § 523(a) in the case of a corporation has no operative effect because § 523(a), as amended, applies only to individuals.

Seven bankruptcy courts and the Ninth Circuit Bankruptcy Appellate Panel have held that the exceptions do not apply to the discharge of a corporation after cramdown confirmation. Focusing on § 523(a)’s language that excepts debts of an individual from a discharge under § 1192, they concluded that the exception in § 1192(2) for “debts of the kind specified” in § 523(a) does not include debts of corporations.¹⁵⁸

The Fourth Circuit in *Cantwell-Cleary Co. v. Cleary Packaging, LLC* (In re *Cleary Packaging, LLC*)¹⁵⁹ reversed one of the bankruptcy courts. Focusing on § 1192(2)’s language that excepts “the kind of debt” listed in § 523(a), the court reasoned that it refers to the kind of debt listed in § 523(a), not the kind of debtor that § 523(a) addresses.¹⁶⁰ Thus, the court concluded, “the debtors covered by the discharge language of § 1192(2)—i.e., both individual and corporate debtors—remain subject to the 21 kinds of debt listed in § 523(a).”¹⁶¹

Sections A and B of this Part discuss the competing textual analyses and the reasons the courts advance to support them.

A. The Bankruptcy Courts’ Interpretation: § 523(a)’s Exceptions Do Not Apply to Discharge of Corporation After Cramdown Discharge

The first bankruptcy court to conclude that the § 523(a) exceptions do not apply to the discharge of a corporation after cramdown discharge was *Gaske v. Satellite Restaurants, Inc. Crabcake Factory USA* (In re *Satellite Restaurants, Inc. Crabcake Factory USA*).¹⁶² Another judge in the same district adopted and expanded its analysis in *Cantwell-Cleary Co. v. Cleary Packaging, LLC* (In re *Cleary Packaging LLC*).¹⁶³ Five later bankruptcy court opinions and the Ninth Circuit Bankruptcy Appellate Panel followed the approach of these cases.¹⁶⁴

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The bankruptcy courts focused on the text of [§ 523\(a\)](#) and invoked two principles of statutory construction to support the conclusion that the discharge exceptions apply only to an individual. The first is the familiar rule that the plain meaning of the text governs interpretation of the bankruptcy statutes unless such an interpretation produces an absurd result.¹⁶⁵ The second is that “every word must be given meaning so that no word in a statute is rendered superfluous.”¹⁶⁶

For the bankruptcy courts, the critical text is the preamble of [§ 523\(a\)](#). As Part III(D) discusses, the preamble states that a discharge under [§ 1192](#) does not discharge *an individual debtor* from any of the 21 types of listed debts. This clear and unambiguous language, the bankruptcy courts concluded, makes the exceptions applicable only to the [§ 1192](#) discharge of an individual.¹⁶⁷

Thus, the bankruptcy court in *Avion Funding, LLC v. GFS Industries, Inc. (In re GFS Industries, LLC)*¹⁶⁸ reasoned that the reference in [§ 1192\(2\)](#) to [§ 523\(a\)](#) incorporates, but does not expand, its list of nondischargeable debts and, therefore, the language of [§ 1192](#) does not except any debts from discharge that [§ 523\(a\)](#) does not already except. The court concluded: “Because [§ 523\(a\)](#) unequivocally applies only to individuals, the language of [§ 1192\(2\)](#) does not empower [§ 523\(a\)](#) to cast a wider net than the text of [§ 523\(a\)](#) permits.”¹⁶⁹

The *GFS Industries* court observed that the discharge provisions of [§ 1141\(d\)](#) distinguish exceptions by the type of debtor in that [§ 1141\(d\)\(2\)](#) states that the [§ 523\(a\)](#) exceptions apply to the discharge of an individual and [§ 1141\(d\)\(6\)](#)¹⁷⁰ excepts certain debts from the discharge of a corporation.¹⁷¹ Reasoning that “Congress knew, when it drafted [§ 1192\(2\)](#), how to distinguish dischargeability based on the type of debtor [and that] Congress did not make this distinction in [§ 1192\(2\)](#),” the court concluded that “in order to determine to which debtors [§ 1192\(2\)](#) refers, one must look to the language of [§ 523\(a\)](#), which unequivocally applies only to individuals.”¹⁷²

A contrary interpretation, the bankruptcy courts reasoned, would render SBRA’s amendment of [§ 523\(a\)](#) to insert [§ 1192](#) superfluous. [Section 1192\(2\)](#) states that a [§ 1192](#) discharge does not discharge a debt “of the kind specified in [§ 523\(a\)](#).” For the exceptions in [§ 523\(a\)](#) to apply to discharges of individuals and entities under [§ 1192\(2\)](#), it is not necessary to add [§ 1192](#) to [§ 523\(a\)](#).¹⁷³

As the court in *Crabcake Factory* noted, the reference to [§ 1192](#) in [§ 523\(a\)](#) must mean something, and “the only reasonable meaning is that Congress intended to limit application of the [§ 523\(a\)](#) exceptions in a Subchapter V case to individuals.”¹⁷⁴ In other words, as the *Cleary Packaging* bankruptcy court stated, the only function of the addition of “[§ 1192](#)” to the qualifying language of [§ 523\(a\)](#) “is to limit application of [§ 523\(a\)](#) to individual debtors in Subchapter V cases.”¹⁷⁵ The *Cleary Packaging* court reasoned: “This is not simply the logical reading of the statute but also it is the result mandated by common principles of statutory construction.”¹⁷⁶

Similarly, the *Crabcake Factory* bankruptcy court concluded: “When giving effect to every word of the statute, the plain language of [Section 523\(a\)](#) is unequivocal and confirms that the exceptions to a debtor’s discharge, including a discharge under [Section 1192](#), apply only to an individual.”¹⁷⁷ The bankruptcy court in *Cleary Packaging* put it this way: “[T]he Code, read holistically and in accordance with common principles of statutory interpretation, limits the application of [section 523](#) in Subchapter V cases to individual debtors.”¹⁷⁸

The bankruptcy courts reviewed the legislative history of subchapter V (which [Section III\(D\)](#) discusses) and found nothing that indicated that Congress intended to expand the exceptions to discharge in [§ 523\(a\)](#) to a corporation.¹⁷⁹

In addition, the bankruptcy courts noted the well-settled law that the exceptions in [§ 523\(a\)](#) do not apply to a chapter 11 discharge of a corporation.¹⁸⁰ Indeed, in enacting the Bankruptcy Code in 1978, Congress expressly considered and rejected the approach

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of one of the former reorganization chapters under the Bankruptcy Act, chapter XI, that provided for objections to the discharge of a corporation, as Section III(C)(1) discusses. ¹⁸¹

The bankruptcy court in *Cleary Packaging* ¹⁸² discussed Professor Brubaker's analysis, which Section III(C)(1) summarizes, and his conclusions (1) that the exceptions in chapter XI cases to a corporation's discharge for fraud and other debts "posed a substantial impediment to the ability of certain debtors to reorganize" under chapter XI, and (2) that the corporate discharge provisions in chapter 11 (the single reorganization chapter that replaced former chapters X, XI, and XII) reflected "the considered judgment that *any* corporate discharge exception 'would leave an undesirable uncertainty surrounding reorganizations that is unacceptable.'" ¹⁸³

The *Cleary Packaging* bankruptcy court noted ¹⁸⁴ that the only exception to the discharge of a corporation in a traditional chapter 11 case is in § 1141(d)(6) (excepting claims of a domestic governmental unit based on fraud, claims under the False Claims Act and similar statutes, and certain taxes involving fraud or evasion) and that it took eight years for that provision to be enacted. ¹⁸⁵

From this, the bankruptcy court in *Cleary Packaging* concluded, "[T]he 1978 Code represented an intentional and decisive change by Congress with respect to the scope of a corporate debtor's discharge." ¹⁸⁶

Accordingly, the *Cleary Packaging* bankruptcy court reasoned, "[T]he suggestion that Congress incorporated [21] new exceptions to discharge for small corporations in a bill [the SBRA] that was introduced in April 2019, and signed into law by the President in August 2019, seems not only improbable but also contradicts years of bankruptcy law and policy. 'Congress does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes.'" ¹⁸⁷

Similarly, after noting that Congress chose to include subchapter V in chapter 11, the *GFS Industries* court concluded: ¹⁸⁸

The idea that Congress would aim to create a simpler option for a corporation to pursue bankruptcy while simultaneously implementing impediments to that debtor achieving a discharge of debts defies reason.

Simply put, the bankruptcy courts concluded that Congress did not intend that § 1192(2) change well-established law and its consciously-enacted chapter 11 policy regarding exceptions to a corporation's chapter 11 discharge.

The *Cleary Packaging* bankruptcy court concluded that the scope of the chapter 11 discharge should be the same in all chapter 11 cases. The court explained: ¹⁸⁹

Although the entities at issue in a Subchapter V case are smaller than those in most traditional chapter 11 cases, the state law structure of these entities and their need for a balance sheet restructuring are akin to larger chapter 11 cases. These entities act in the same general manner and should be subject to the same potential liabilities through the chapter 11 process. In fact, history has shown that individuals running very large corporations are capable of using the entity for improper purposes, yet the entity receives a discharge in chapter 11 if its plan is confirmed. It seems incongruent that Congress would penalize a smaller entity for similar individual conduct.

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The *Cleary Packaging* bankruptcy court also noted that the § 523(a) exceptions do not apply to a discharge granted upon confirmation of a consensual subchapter V plan under § 1191(a)—an outcome determined by class voting, not the actions of individual creditors. Thus, if enough creditors in a class that includes a creditor who claims a nondischargeable debt accept it (and all other impaired classes accept it), consensual confirmation under § 1191(a) discharges the allegedly nondischargeable claim.¹⁹⁰

The court concluded, “[A]ny such result is arbitrary and undermines the equality principles of creditor treatment under the Code.”¹⁹¹

The bankruptcy courts in *Cleary Packaging*¹⁹² and *GFS Industries*¹⁹³ addressed the comparable provisions of the chapter 12 discharge provisions and the two chapter 12 cases,¹⁹⁴ which Section III(C)(3) discusses, that held that the chapter 12 exceptions to discharge apply to corporations.¹⁹⁵

The *Cleary Packaging* bankruptcy court distinguished them based on two important differences between chapter 12 and subchapter V.¹⁹⁶ First, subchapter V is an alternative for a business entity and applies to a much broader array of entities than those eligible for chapter 12 as family farmers and fishers. Second, subchapter V incorporates the discharge provisions of § 1141(d) in the context of a consensual plan. Unlike the chapter 12 discharge provision, § 1141(d) distinguishes between individual and corporate discharges.

The *Cleary Packaging* bankruptcy court concluded, “The lack of such distinction within Chapter 12 considered in conjunction with the narrowly circumscribed type of entity that may be a Chapter 12 debtor renders analogy between the two discharge provisions unpersuasive.”¹⁹⁷

Moreover, the bankruptcy court in *Cleary Packaging* noted that the plain language of the chapter 12 provision “could support a result different than that reached by the courts” in the chapter 12 cases.¹⁹⁸

The *Cleary Packaging* bankruptcy court summarized its ruling as follows:¹⁹⁹

The Court appreciates and understands the overlap of Subchapter V with chapters 12 and 13 of the Code. The similarities in the overall structure between Subchapter V and chapters 12 and 13 cannot and should not be denied. Many aspects of chapters 12 and 13 serve a valuable function in streamlining the reorganization process for Subchapter V debtors.

The Court cannot, however, extend those similarities to the scope of the discharge for entity debtors. The nature and purpose of the discharge are different for corporate debtors, and those differences must, in this Court's opinion, be respected in Subchapter V.

The Court is persuaded by Congress' rejection of prior exceptions to discharge for corporate debtors and, more importantly, the plain language that Congress used in § 523(a) to confine those exceptions to individual debtors. Absent clear and unambiguous direction from Congress to deviate from that approach, the Court finds that a corporation's discharge under § 1192 of the Code is unimpeded by § 523(a) of the Code.

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The bankruptcy court in *GFS Industries* likewise distinguished the chapter 12 cases and reasoned that its ruling could be harmonized with the one that had arisen in its district because the difference between the operation of chapter 11 and chapter 12 corporate discharges was critical to interpretation of the chapter 12 provision.²⁰⁰ Specifically, the *GFS Industries* court observed, the chapter 12 case had pointed out that the chapter 11 discharge provision was narrower, excepting only debts of a liquidating corporation and debts of an individual under § 523(a), and that the discharge of a corporation in a chapter 11 case was not subject to § 523(a) exceptions.²⁰¹ This analysis of discharges in chapter 11 cases remained applicable in subchapter V cases, the *GFS Industries* court concluded, because subchapter V is a subchapter of chapter 11, not its own chapter.²⁰² In addition, the court said, the chapter 12 ruling had recognized the uniqueness of chapter 12 as providing special treatment for certain kinds of debtors.

The *GFS Industries* court concluded:²⁰³

In short, because Chapter 12 is only available to a small and specific subset of debtors, Chapter 12 cases have unique considerations that are not present in a Chapter 11 case. Therefore, the Court is not mandated to extend the holding that Chapter 12 corporate debtors are subject to § 523 dischargeability actions in Subchapter V notwithstanding the similar language between §§ 1228(a) and 1192(2).

The Ninth Circuit Bankruptcy Appellate Panel in *Lafferty v. Off-Spec Solutions, LLC (In re Off-Spec Solutions, LLC)*²⁰⁴ concluded, as the *Cleary Packaging* bankruptcy court suggested, that the chapter 12 and subchapter V discharge provisions “should be interpreted similarly, but neither provision expands the scope of § 523(a) to apply to corporate debtors.”

B. The Fourth Circuit's Ruling: § 523(a) Discharge Exceptions Apply to Discharge of Corporation After Cramdown Discharge

The Fourth Circuit's contrary analysis in *Cantwell-Cleary Co. v. Cleary Packaging, LLC (In re Cleary Packaging LLC)*,²⁰⁵ reversing the bankruptcy court on direct appeal, focuses on the text of § 1192(2) “as the provision that specifically governs discharges” in a subchapter V case.²⁰⁶ The Fourth Circuit reasoned that the critical language of § 1192(2) is its exception of “any debt ... of the kind” specified in § 523(a). The Fourth Circuit concluded that use of the word “debt” was decisive because “it does not lend itself to encompass the ‘kind’ of debtors discussed in the language of § 523(a).”²⁰⁷

The Fourth Circuit explained, “the combination of the terms ‘debt’ and ‘of the kind’ indicates that Congress intended to reference only the list of non-dischargeable debts found in § 523(a).”²⁰⁸ This interpretation of “of the kind,” the court continued, is in line with the ordinary dictionary meanings of “kind” as “category” or “sort.”

The court summarized its ruling:²⁰⁹

[W]hile § 523(a) does provide that discharges under various sections, including § 1192 discharges, do not “discharge an individual debtor from any debt” of the kind listed, § 1192(2)'s cross-reference to § 523(a) does not refer to any kind of debtor addressed by § 523(a) but rather to the kind of debt listed in § 523(a). By referring to the kind of debt listed in § 523(a), Congress used a shorthand to avoid listing all 21 types of debts, which would indeed have expanded the one-page section to add several additional pages to the U.S. Code. Thus, we conclude that the debtors covered by the discharge language of § 1192(2)—i.e., both individual and corporate debtors—remain subject to the 21 kinds of debt listed in § 523(a).

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To the extent that tension existed between the language of § 523(a) addressing individual debtors and the language of § 1192(2) addressing both individual and corporate debtors, the court added, the more specific language of § 1192(2) dealing only with subchapter V discharges should govern over the more general provisions of § 523(a) that reference other discharges under the Bankruptcy Code.²¹⁰

The Fourth Circuit in *Cleary Packaging* did not address the bankruptcy court's analysis of legislative history, the history of exceptions to discharge in chapter 11 cases, or the need for consistency in the scope of the discharge of a corporation in subchapter V and chapter 11 cases. Instead, the court made four points about “the context of § 1192(2) within the Bankruptcy Code and the Bankruptcy Code's structure”²¹¹ that supported its interpretation and a fifth point based on “equity and fairness.”²¹²

First, the Fourth Circuit reasoned that “Congress conscientiously defined and distinguished the kinds of debtors” covered by the discharge provisions in chapters 7, 11, and 13.²¹³ Entities cannot get a discharge in chapter 7 and 13 cases. In traditional chapter 11 cases, Congress “explicitly distinguished” individual and corporate discharges by excluding different debts from each. The court referenced § 1141(d)(2), which excepts debts listed in § 523(a) from an individual's discharge, and § 1141(d)(6), which provides the only exception to a corporate discharge.²¹⁴ In contrast, the court concluded, “Congress purposefully addressed both individual and corporate debtors when defining the right of discharge in Subchapter V proceedings.”²¹⁵

In other words, the Fourth Circuit's reasoning is that the inclusion of an exception in the discharge provision for a traditional case in § 1141(d) and the absence of a distinction between corporate and individual discharges in § 1192 must mean that the § 1192 provision does not make the distinction. This is the same point that Judge Small made in his analysis of the chapter 12 discharge provisions to support the conclusion that the exceptions applied to corporations as well as individuals.²¹⁶

The Fourth Circuit's second point is that the bankruptcy court's interpretation would “create difficulty in reconciling § 523(a) with § 1141(d)(6).”²¹⁷ It noted that, under the bankruptcy court's interpretation, the limiting language in § 523(a)'s preamble, as applicable to a discharge in a traditional chapter 11 case, would make the exceptions in § 523(a) applicable only to an individual discharge but that the exception to a corporate discharge in § 1141(d)(6) also incorporates specified debts “of a kind” listed in § 523(a).²¹⁸ The Fourth Circuit did not elaborate on the concern other than to note that the debtor had been “unable to reconcile its method for applying § 523(a) to § 1192 with any consistency as to how it would apply § 523(a) to § 1141(d)(6).”²¹⁹

The third point that the Fourth Circuit advanced, which it described as “more telling,” is “Congress's importation of language into Subchapter V from the conceptually similar Chapter 12 proceedings.”²²⁰ The Fourth Circuit observed that the chapter 12 discharge provisions except debts from discharge in the same way as § 1192 and that § 523(a) references the chapter 12 discharge statutes in the same way it references § 1192.²²¹ The Fourth Circuit cited the decisions of the two bankruptcy courts that had determined that the § 523(a) exceptions applied to a corporation's chapter 12 discharge.²²² These interpretations, the court concluded, supported its interpretation of § 1192(2)'s “virtually identical” language, referring to the principle that “identical words and phrases within the same statute should normally be given the same meaning.”²²³

The Fourth Circuit's fourth point is that § 1192(2)'s identical treatment of the discharges of individual and corporate debtors “makes particular sense when considering that subchapter's juxtaposition in Chapter 11 with traditional Chapter 11 provisions, reflecting its distinctive purpose within that Chapter.”²²⁴

The court noted that Congress enacted subchapter V with the primary goal of simplifying chapter 11 reorganizations for small businesses and reducing administrative costs. To accomplish this purpose, the court continued, “Congress deliberately altered the general provisions of traditional Chapter 11 proceedings by, among other things, eliminating the absolute priority rule and limiting the applicability of § 1141(d) to subchapter V proceedings.”²²⁵ The court again noted, in particular, that the discharge provisions of § 1141(d) distinguish between corporate and individual discharges but that “§ 1192 provides benefits to small business debtors regardless of whether they are individuals or corporations.”²²⁶

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Adoption of the bankruptcy court's interpretation, which would treat individuals and corporations differently under [§ 1192\(2\)](#), the Fourth Circuit concluded, would frustrate "an important purpose" for subchapter V. ²²⁷

Fifth, the Fourth Circuit supported application of the [§ 523\(a\)](#) exceptions to a corporation's discharge after cramdown confirmation based on considerations of "equity and fairness" arising from elimination of the absolute priority rule. ²²⁸ After noting that elimination of the absolute priority rule allows a corporation's owners in a subchapter V case to retain their ownership interests "at the expense of and over the objection of creditors," the court stated: ²²⁹

Given the elimination of the absolute priority rule, Congress understandably applied limitations on the discharge of debts to provide an additional layer of fairness and equity to creditors to balance against the altered order of priority that favors the debtor. To this end, *all subchapter V debtors* are textually subject to the discharge limitations described in [§ 523\(a\)](#), not just individual Subchapter V debtors. To make a distinction between individuals and corporations for how Subchapter V is applied would not only undermine that balance, but would also make no sense and indeed would create perverse incentives.

The Fourth Circuit thus connected the cramdown discharge provision in [§ 1192](#) with elimination of the absolute priority rule and concluded that making a distinction with regard to exceptions to discharge would: (1) undermine the balancing of its elimination by adding an additional layer of fairness and equity; (2) make no sense; and (3) create perverse incentives.

In summary, after a close textual analysis and contextual review of [§ 1192\(2\)](#), the Fourth Circuit ruled that [§ 1192\(2\)](#) provides discharges to subchapter V debtors, whether they are individuals or corporations, except for the debts listed in [§ 523\(a\)](#), as the specific provision covering discharge, and that it applies to individual and corporate debtors alike. ²³⁰

The Fourth Circuit concluded its opinion with this observation: ²³¹

[W]e conclude that our interpretation serves fairness and equity in circumstances where a *small business corporate debtor* in particular is given greater priority over creditors than would ordinarily apply and thus should not especially benefit from the discharge of debts incurred in circumstances of fraud, willful and malicious injury, and other violations of public policy reflected in [§ 523\(a\)](#)'s list of exceptions.

V. Analysis of the Competing Interpretations

This Part analyzes the competing interpretations of the interplay between [§ 1192\(a\)](#) and [§ 523\(a\)](#). It begins in Section V(A) with an examination of the texts of the statutes.

The Fourth Circuit acknowledged that the question is a "close one." ²³² Because the text alone may not provide a clear answer, the interpretive task is to determine congressional intent from legislative history, the context of the statutes within the Bankruptcy Code and the structure of the Bankruptcy Code, and the statutory purposes of the provisions. Section V(B) considers the various rationales that the courts advance to support their opposing views in light of the policy choice that Congress made to provide a chapter 11 discharge to a reorganized corporation without exceptions.

A. The Texts of the Statutes

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The bankruptcy court in *Cleary Packaging*²³³ and other bankruptcy courts and the Ninth Circuit Bankruptcy Appellate Panel²³⁴ conclude that the discharge of a corporation under § 1192 is not subject to the § 523(a) exceptions. On appeal, the Fourth Circuit in *Cleary Packaging* concluded that a corporate discharge under § 1192 is subject to the exceptions.²³⁵

The key to proper interpretation of the statute is the fact that SBRA amended § 523(a) in connection with enactment of § 1192 to govern the cramdown discharge.

As amended, the preamble to § 523(a) states that a discharge under § 1192 does not discharge an individual from the debts § 523(a) lists. Section 1192(2) states that the discharge is subject to exceptions “of the kind specified” in § 523(a). The bankruptcy courts applied the plain meaning of § 523(a) to conclude that § 1192(2) did not except debts of a corporation.²³⁶

The Fourth Circuit, however, concluded that “debt of the kind specified in § 523(a)” referred to the kind of debt it lists, not the kind of debtor it addressed. The court noted that dictionary definitions of “kind” as meaning “category” or “sort” supported this reading. The court explained that the reference in § 1192(2) to the debts in § 523(a) was a “shorthand” to avoid listing all of the 21 types of debt it specifies, thus avoiding the addition of several pages to the United States Code.²³⁷ Section 1192(2), standing alone, would clearly accomplish this.

The problem is that Congress did more than simply refer to § 523(a). It also amended it to include § 1192 in the list of discharges that do not discharge an individual from the specified debts. This contemporaneous legislation must have meaning. It must mean that the exceptions apply only to the discharge of an individual. Otherwise, the insertion of “§ 1192” into the preamble of § 523(a) has no meaning at all and is superfluous.

The reasoning that the dictionary definitions of “kind” as meaning “category” or “sort” require the conclusion that § 1192(2) refers only to the list of debts is not persuasive. A “category” or “sort” of debts can be the debts of an individual just as much as a “category” or “sort” of debts is only the debts themselves.

The Fourth Circuit also concluded that the specific language of § 1192, which addresses only cramdown discharges, properly controls over the more general language of § 523(a), which references numerous discharge provisions of the Bankruptcy Code.²³⁸ The statutory construction principle is accurate, but the application is not.

The issue here does not involve two statutory provisions that say different things. The question, rather, is whether to give effect to a reference in one statute to the provisions of another. Giving effect to a more specific statute over a general one is not appropriate when the result makes the general one superfluous.

The foregoing analysis of the texts of the statutes favors the bankruptcy courts' interpretation. The bankruptcy courts concluded that the plain meaning of the statutes required this conclusion,²³⁹ but the Fourth Circuit's contrary ruling (and the two bankruptcy cases interpreting identical provisions in chapter 12 in the same way²⁴⁰) indicate that both interpretations are plausible. Each side of the debate advances additional rationales in support of its interpretation, which the next Section examines.

B. Rationales In Support of Competing Interpretations

1. Congressional policy choice of chapter 11 discharge without exceptions for reorganized corporation

When a statute is capable of two or more meanings, the interpretive task is to determine the intent of Congress.²⁴¹ Prior bankruptcy practice is important in the determination of Congressional intent with regard to amendments to the Bankruptcy Code under the assumption that Congress does not intend to “erode past bankruptcy practice absent a clear indication that Congress intended such a departure.”²⁴²

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Determination of Congressional intent with regard to exceptions to the [§ 1192](#) discharge thus begins with discussion of the existing chapter 11 statute governing exceptions to corporate discharges and the Congressional policy choice that Congress made in enacting that statute.

As Professor Brubaker's work, summarized in earlier text, ²⁴³ thoroughly documents, Congress gave “careful scrutiny” to the differing scope of the corporate discharge as between chapters X and XI in the 1978 enactment of chapter 11 as a unitary chapter to govern all reorganizations. Congress was informed by the chapter XI experience that “the chapter XI discharge exceptions invited holdout creditor problems of the sort that plague non-bankruptcy workouts and that are the very impetus for a federal bankruptcy reorganization process (that can fully bind dissenters to a restructuring plan).” ²⁴⁴

Congress decided “to provide for the chapter 11 discharge of a corporation even *more* comprehensive than that available under chapter X.” ²⁴⁵ The choice reflected “the considered judgment that *any* corporate discharge exception “would leave an undesirable uncertainty surrounding reorganizations that is unacceptable.” ²⁴⁶ Congress thus recognized the economic and practical principle that reorganization of a corporation's debts and the equal treatment of creditors require a discharge without exceptions. ²⁴⁷

Congress made a clear policy choice when it enacted chapter 11 in 1978 in favor of a chapter 11 discharge for a corporation without any exceptions. Because Congress enacted subchapter V as a part of chapter 11 (as opposed to enacting a separate chapter for smaller businesses, as it did for farmers in chapter 12), the same policy choice properly governs subchapter V cases. Congress enacted subchapter V to address problems of smaller businesses in chapter 11 cases. It could not have intended to depart from an exceptionless discharge for corporations that is an essential element for their effective reorganization. The *GFS Industries* court made the point this way: ²⁴⁸

The idea that Congress would aim to create a simpler option for a corporation to pursue bankruptcy while simultaneously implementing impediments to that debtor achieving a discharge of debts defies reason.

It is important to recognize that this Congressional policy arises from an explicit choice that Congress made and enacted into law. It is not a policy that courts developed or inferred from other provisions of the Bankruptcy Code based on an assessment of its purposes. Congress enacted this policy deliberately with full awareness that it was doing so and after careful consideration of it.

This fundamental Congressional policy not only compels the conclusion that the [§ 523\(a\)](#) exceptions do not apply to the cramdown discharge of a corporation. It also informs the analysis of all the reasons the courts advance in support of their interpretations of the interplay between [§ 1192\(2\)](#) and [§ 523\(a\)](#).

2. Legislative history

Subchapter V's legislative history supports the conclusion that Congress did not intend to make the [§ 523\(a\)](#) exceptions applicable to the [§ 1192](#) discharge of a corporation. The legislative history is important for what it says as well as for what it does not say.

The Report of the Judiciary Committee of the House of Representatives states that the [§ 1192](#) discharge excepts debts on which the last payment is due after the commitment period under the plan and “any debt that is otherwise nondischargeable.” ²⁴⁹ The words “otherwise nondischargeable” logically refer to [§ 523\(a\)](#), which applies only to individuals.

Perhaps more important is what the Report does not say. If the drafters had intended to create exceptions to the discharge of corporations by expanding [§ 523\(a\)](#) to permit them—a significant change in existing chapter 11 law—one would expect the House Judiciary Committee Report to point that out. It does not. ²⁵⁰ To the contrary, the Report's explanation that the exceptions

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are for “any debt that is otherwise nondischargeable” demonstrates an intent to apply existing exceptions to discharge in chapter 11 cases in subchapter V, not to expand them.

This conclusion becomes compelling in view of the fact that, as the preceding section explains, Congress in enacting chapter 11 in 1978 carefully and deliberately decided that the discharge of a corporation would not be subject to exceptions. ²⁵¹

As the bankruptcy court in *Cantwell-Cleary Co. v. Cleary Packaging, LLC (In re Cleary Packaging LLC)*, ²⁵² aptly observed, Congress does not “hide elephants in mouseholes.” ²⁵³

Perhaps Congress in 2019 had a different view of exceptions to a corporation's discharge in the case of cramdown confirmation in a subchapter V case than Congress in 1978. But it is difficult to conclude that, in enacting a statute universally proclaimed to have the purpose of facilitating reorganization of smaller businesses by, among other things, eliminating the absolute priority rule in a cramdown situation, Congress in 2019 intended to re-introduce all the problems with exceptions to the discharge of a corporation that it eliminated over 50 years earlier. It is even more difficult, if not impossible, to conclude that it did so without any mention of it.

3. The Structure of the Bankruptcy Code: Treatment of Discharge Exceptions in § 1141(d) and § 1192(2)

The Fourth Circuit in *Cleary Packaging* ²⁵⁴ reasoned that “Congress purposefully addressed both individual and corporate debtors when defining the right of discharge in Subchapter V proceedings” as it had in chapters 7, 11, and 13 ²⁵⁵ and “conscientiously defined and distinguished the kinds of debtors” covered by each discharge. The point is that the § 523(a) exceptions must apply to discharges of corporations as well as individuals because § 1192 does not distinguish between them.

As an initial matter, the discharge provisions of chapters 7 and 13 are irrelevant to the issue. Chapter 7 is a liquidation proceeding, so a corporation effectively no longer exists after the filing of a chapter 7 case. The reason for denying a discharge to a corporation in a liquidation case is to avoid trafficking in corporate shells and bankrupt partnerships. ²⁵⁶ Section 727(a)(1) clearly and simply distinguishes individuals and corporations by providing that corporations do not receive a discharge. The same prohibition exists in a chapter 11 case when a corporation liquidates assets and does not remain in business. ²⁵⁷

A corporation cannot receive a chapter 13 discharge because it is not eligible to be a chapter 13 debtor under § 109(e). ²⁵⁸ Chapter 13 distinguishes between corporations and individuals by making only individuals eligible for chapter 13, not through a discharge provision.

The distinctions in the operation of the discharge provisions of chapter 7 and 13 between individuals and corporations and other entities, therefore, shed no light on the interpretation of chapter 11 and subchapter V provisions that deal with exceptions to discharge.

A review of the structure of the discharge provisions of § 1141(d) and § 1192(2) helps to understand the Fourth Circuit's point about distinctions between exceptions to discharge for individuals and corporations in chapter 11 and subchapter V cases.

Section 1141(d) provides for a discharge in a traditional or small business case (and after consensual confirmation in a subchapter V case) in one paragraph applicable to all debtors (§ 1141(d)(1)(A)) and excepts debts specified in § 523(a) from an individual's discharge in another (§ 1141(d)(2)). An amendment to § 1141(d) in 2005 added § 1141(d)(6) to except certain debts from a corporation's discharge that were already excepted from an individual's discharge under § 523(a). ²⁵⁹ In a subchapter V case, § 1192(2) excepts debts in § 523(a) without limiting its application to individuals.

The Fourth Circuit's conclusion in *Cleary Packaging* is that Congress must have intended that the § 523(a) exceptions apply to all cramdown discharges because § 1192 does not distinguish between corporations and individuals whereas § 1141(d) does in paragraphs (2) and (6).

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The structures of § 1141(d) and § 1192(2) support the Fourth Circuit's interpretation, but they do not compel it. Importantly, the reasoning does not account for the language in the preamble of § 523(a), which limits its exceptions to discharges of individuals under both § 1141(d) and § 1192: "A discharge under section 727, 1141, 1192, 1228(a), 1228(b), or 1328(b), or 1328(b) of this title does not discharge an *individual debtor*" from any the debts listed in § 523(a).²⁶⁰

In considering what the structures of § 1141(d) and § 1192 say about Congressional intent, it is instructive to consider their origins. Section 1141(d) was enacted to distinguish between exceptions to discharge of individuals and corporations in a chapter available to both. Section 1192, in contrast, comes from the chapter 12 discharge provisions, which imported the hardship discharge provision in chapter 13. Section 1192, therefore, has its genesis in the statute providing for chapter 13 that applied and still applies only to individuals. Congress thus imported statutory language originally enacted to govern discharge exceptions in chapter 13 cases, only available to individuals, to govern discharge in subchapter V cases available to corporations as well as individuals.

Moreover, the fact that, unlike § 1192, § 1141(d) makes distinctions between exceptions to individual and corporate discharges supports the conclusion that the § 523(a) exceptions do not apply to the § 1192 discharge of a corporation. As the *GFS Industries*²⁶¹ court pointed out, "Congress knew, when it drafted § 1192(2), how to distinguish dischargeability based on the type of debtor [and] did not make this distinction in § 1192(2)." The conclusion is that § 523(a), which applies only to individuals, governs the issue.²⁶²

The real question is whether Congress intended to make the exceptions applicable to a corporate discharge. How Congress distinguished between individuals and corporations in § 1141(d) does not properly address the question of what it intended to do with different language in § 1192. Better guides to Congressional intent take account of the language of § 523(a), the chapter 11 policy of corporate discharges without exception, and the legislative history of subchapter V, all of which support the bankruptcy courts' interpretation that the discharge exceptions do not apply in the case of a corporation.

4. The anomaly of the § 1141(d)(6) exception to corporate discharges

The Fourth Circuit in *Cleary Packaging*²⁶³ reasoned that, if § 1192(2) does not except debts of a corporation after cramdown discharge under the bankruptcy court's interpretation, then it would be difficult to reconcile § 523(a) with § 1141(d)(6).²⁶⁴

Two issues involving § 1141(d)(6) arise from the bankruptcy courts' interpretation.

First, if § 1192(2) does not except debts of a corporation after cramdown discharge, the discharge will discharge debts that § 1141(d)(6) excepts, because § 1141(d) does not apply in the case of cramdown confirmation under § 1181(c). If the § 523(a) exceptions apply to a cramdown discharge, however, the § 523(a) exceptions include the debts excepted in § 1141(d)(6). Debts excepted from discharge under § 1141(d)(6) are excepted from a consensual discharge because § 1141(d) governs the discharge.

The bankruptcy courts' interpretation thus results in application of the § 1141(d)(6) discharge exceptions to a discharge after consensual confirmation but not after cramdown confirmation. The fact that a corporation under the bankruptcy courts' interpretation can escape nondischargeability of a § 1141(d)(6) debt through cramdown confirmation but not through consensual confirmation is troublesome and, perhaps, the best argument in favor of the Fourth Circuit's interpretation.²⁶⁵ In this situation, it is true that, under the bankruptcy courts' interpretation, a corporation has an incentive to seek cramdown confirmation rather than consensual confirmation so that it receives a broader discharge, perhaps one of the "perverse incentives" that concerned the Fourth Circuit.²⁶⁶

The anomaly is troubling, but it does not provide a persuasive basis for concluding that Congress intended to except *all* types of § 523(a) debts from discharge in order to preserve exceptions for the few to which § 1141(d)(6) applies. The reality is that § 1141(d)(6) rarely arises in reported chapter 11 cases. In the 18 years that the statute has been effective, only one court has concluded that the exception applies.²⁶⁷ The problem of exceptions to discharge under § 523(a) generally, in contrast, is widespread: § 523(a) excepts 21 types of debts.

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In view of the chapter 11 policy that the [§ 523\(a\)](#) exceptions not apply to a corporation's chapter 11 discharge and the rare, almost nonexistent application of [§ 1141\(d\)\(6\)](#), it is unlikely that Congress was concerned about this result, assuming it was aware of it. Congress, after all, adopted the language of chapter 12, and not [§ 1141\(d\)](#), for purposes of the cramdown discharge. The fact that a corporation can receive a broader discharge in a cramdown case if no exceptions exist than in a consensual case with regard to types of debts that rarely arise does not indicate that Congress intended to depart from the intentional and deliberate elimination of exceptions to discharge in corporate cases. The result is no more anomalous than a conclusion that Congress intended to except all [§ 523\(a\)](#) debts in order to include a few debts that rarely arise.

The second issue involves the specific language of [§ 1141\(d\)\(6\)\(A\)](#). Subparagraph (A) provides that the [§ 1141\(d\)\(1\)](#) discharge does not discharge a corporation from certain debts “of the kind specified” in [§ 523\(a\)\(2\)\(A\) or \(B\)](#). Under the bankruptcy courts' interpretation, “of the kind specified in [§ 523\(a\)](#)” limits the [§ 1192\(2\)](#) exception to debts of individuals. The result of application of this meaning to the same words in [§ 1141\(d\)\(6\)\(A\)](#) is that [§ 1141\(d\)\(6\)](#) effectively states that the chapter 11 discharge in a traditional case does not discharge a corporation from debts owed to certain creditors of the kind specified in [§ 523\(a\)\(2\)\(A\) or \(B\)](#) *that are debts of individuals*.

The resulting interpretation—that [§ 1141\(d\)\(6\)](#) does not except debts of a corporation from debts owed by an individual—is absurd and contradicts its express language. Accordingly, the conclusion is that the bankruptcy courts' interpretation of [§ 523\(a\)](#) as limiting exceptions to discharge in [§ 1192\(2\)](#) to individuals cannot be correct because the same interpretation makes no sense when applied to [§ 1141\(d\)\(6\)\(A\)](#).

The correct premise for this conclusion is that the bankruptcy courts' reading of “of the kind specified” in [§ 1192](#) makes no sense when applying [§ 1141\(d\)\(6\)\(A\)](#). This does not, however, require that the same words have the same effect in [§ 1141\(d\)\(6\)\(A\)](#) or that the words that make sense in [§ 1141\(d\)\(6\)\(A\)](#) must be interpreted the same way in [§ 1192](#).

The reason is that [§ 1141\(d\)\(6\)\(A\)](#) was enacted in 2005 as a stand-alone provision that makes a specific exception to the chapter 11 discharge of a corporation.²⁶⁸ It clearly states an exception that is applicable to a corporation regardless of how the language describes the excepted debts. It addressed a specific problem involving a specific category of debts to be excepted from a corporate discharge.

In contrast, [§ 1192\(2\)](#) was enacted in connection with an amendment to [§ 523\(a\)](#) in the same way that [§ 523\(a\)](#) had been amended in 1986 upon enactment of chapter 12. Although enactment of [§ 1192\(2\)](#) and the accompanying amendment to [§ 523\(a\)](#) occurred after enactment of [§ 1141\(d\)\(6\)\(A\)](#), its purpose and effect are the same as those in the chapter 12 legislation enacted in 1986 before the amendment to add [§ 1141\(d\)\(6\)](#). Determination of the meaning of the subchapter V legislation, therefore, properly involves consideration of the meaning of chapter 12 legislation that preceded [§ 1141\(d\)\(6\)\(A\)](#), without regard to how the same language applies in [§ 1141\(d\)\(6\)\(A\)](#).

The chapter 12 discharge provisions in [§ 1228](#) and corresponding amendment to [§ 523\(a\)](#) were part of comprehensive legislation to deal with the reorganization of family farmers that, unlike chapter 13, permitted both family-owned corporations and individuals to file such cases.²⁶⁹ The similar subchapter V provisions were a part of comprehensive legislation to facilitate the reorganization of small businesses, whether corporations or sole proprietorships, that modified important aspects of chapter 11. How Congress used the same words in another specific context ([§ 1141\(d\)\(6\)](#)) does not properly inform the interpretation of another statute ([§ 1192\(2\)](#)) in the context of comprehensive legislation. Conversely, the meaning of the words in the comprehensive legislation does not have to be the same as their meaning in a statute with limited effect where a different meaning is clear.

In other words, the bankruptcy courts' reading of the effect of the limitation of exceptions in [§ 523\(a\)](#) to individuals with regard to the general effect of discharges that it lists does not mean that the same reading is applicable when a specific statute—[§ 1141\(d\)\(6\)\(A\)](#)—references specific subparagraphs of [§ 523\(a\)\(2\)](#) to describe debts that are clearly intended to be excepted from a corporate discharge.²⁷⁰

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5. Exceptions to discharge of corporations in chapter 12 cases

As Section III(C)(3) explains, the language of the exception to discharge in [§ 1192\(2\)](#) is identical to the language of the chapter 12 exception. Likewise, [§ 523\(a\)](#) provides that discharges under [§ 1192](#) and the chapter 12 discharge statutes do not discharge an individual from the debts it lists. The structure and language of the [§ 1192\(2\)](#) discharge exception and the corresponding exception in chapter 12 cases, therefore, are the same.

Two chapter 12 cases ruled that the [§ 523\(a\)](#) exceptions apply to a corporation in a chapter 12 case.²⁷¹ The courts employed the same textual analysis as the Fourth Circuit in *Cleary Packaging*.²⁷²

Observing that subchapter V is “conceptually similar” to chapter 12, the Fourth Circuit cited these cases and concluded that the materially similar discharge provisions should be interpreted the same way.²⁷³

The proposition that subchapter V is “conceptually similar” to chapter 12 is imprecise. Although subchapter V resembles chapter 12 in some ways, it is significantly different in others. Critically, subchapter V is part of chapter 11, and its requirements for confirmation incorporate most of the requirements of [§ 1129\(a\)](#). Thus, more accurately, subchapter V uses chapter 11 as its base and then incorporates some of chapter 12's provisions,²⁷⁴ primarily the [§ 1192](#) discharge provision, the appointment of a trustee in all cases while leaving the debtor in possession,²⁷⁵ and the projected disposable income requirement for cramdown discharge.²⁷⁶

Nevertheless, because the language of the discharge exceptions in [chapter 12 and § 1192\(2\)](#) is identical and the language of 523(a) is the same with regard to both discharges, the holdings in the chapter 12 cases support the Fourth Circuit's ruling.

The bankruptcy court in *Cleary Packaging* addressed the chapter 12 cases and distinguished them based on two important differences between chapter 12 and subchapter V.²⁷⁷ First, subchapter V applies to a much broader array of entities than those eligible for chapter 12 as family farmers and fishers. Second, subchapter V incorporates the discharge provisions of [§ 1141\(d\)](#) in the context of a consensual plan. Unlike the chapter 12 discharge provision, [§ 1141\(d\)](#) distinguishes between individual and corporate discharges.²⁷⁸

The bankruptcy court in *GFS Industries*²⁷⁹ likewise distinguished the chapter 12 cases and reasoned that its ruling could be harmonized with the one that had arisen in its district²⁸⁰ because the difference between the operation of chapter 11 and chapter 12 corporate discharges was critical to interpretation of the chapter 12 provision. The *GFS Industries* bankruptcy court concluded that the differences in chapter 12 and chapter 11 did not mandate extension of the chapter 12 holding to subchapter V cases.²⁸¹

The cases are distinguishable for the reasons the *Cleary Packaging* and *GFS Industries* bankruptcy courts discussed. A further distinction is that the Congressional policy with regard to exceptions to a corporate discharge in chapter 11 cases requires a different result in a subchapter V case than in a chapter 12 case.

The fact remains, however, that the language and structure of the discharge exceptions in [chapter 12 and § 1192\(2\)](#) are the same. The distinctions are not compelling.

The better reason that the chapter 12 cases do not control the outcome is that they are wrong, as the bankruptcy court in *Cleary Packaging*²⁸² suggested and the Ninth Circuit Bankruptcy Appellate Panel in *Off-Spec Solutions*²⁸³ concluded. As Section V(A) explains, the better textual analysis of the interplay between [§ 1192\(2\)](#) and [§ 523\(a\)](#) is that the exceptions do not apply to a corporate discharge. The same textual analysis is applicable to the chapter 12 exceptions and requires the same result.

The chapter 11 policy of an exceptionless discharge for a corporation extends to a corporation in a chapter 12 case for the same reasons. Congress originally enacted chapter 12 in 1986, eight years after it enacted chapter 11 and adopted the exceptionless discharge policy for corporations.

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The chapter 12 cases do not discuss the legislative history of chapter 12.²⁸⁴ As Section III(C)(3) explains, nothing in the legislative history of chapter 12 indicates that Congress intended to change the policy of exceptionless discharges for corporations in chapter 12 cases.

To the contrary, the section-by-section analysis of the legislation in the Senate unequivocally states, “The [chapter 12] discharge is not as broad as that in [chapter 13 \(§ 1328\)](#) and *is the same discharge that the debtor would receive in chapter 11 (§ 1141(d))*.”²⁸⁵

The section-by-section analysis thus notes that the legislation responds to testimony at hearings expressing concern about the adverse effects of a chapter 13 “superdischarge” in the House bill that would have extended availability of chapter 13 to family farmers²⁸⁶ and describes the discharge as being the same as a discharge in chapter 11 cases, as enacted eight years earlier. Nothing in the testimony or other legislative history even mentions the discharge of corporations.

Corporate discharges or their exceptions do not appear in chapter 12’s legislative history. Their absence and the affirmative statement that the chapter 12 discharge is the same as the chapter 11 discharge demonstrate the Congressional intent for chapter 12 not to depart from the policy choice embodied in the enactment of chapter 11: that a reorganized corporation receive an exceptionless discharge.

In any event, the chapter 12 cases are not binding precedent. They represent the views of two bankruptcy judges, three if Judge Small’s discussion is taken into account.²⁸⁷ No appellate court has addressed the issue.

In short, although the chapter 12 cases support the Fourth Circuit’s decision in the sense that they are consistent with it, they provide no additional basis for it. They support the Fourth Circuit’s ruling only if their textual analysis is correct—the question before the Fourth Circuit—and if their reasoning and holdings appropriately apply in the subchapter V context.

The much wider availability of subchapter V than chapter 12; subchapter V’s existence as a part of chapter 11; and subchapter V’s legislative history and well-established chapter 11 law and policy that do not make the [§ 523\(a\)](#) exceptions applicable to a corporation require a fresh examination of the statutory language in the subchapter V context such that reliance on the two chapter 12 cases is not warranted. Perhaps most important, the cases are wrong.

6. The purpose of subchapter V

Interpretation of a statute involves consideration of its purpose.²⁸⁸

The Fourth Circuit in *Cleary Packaging* supported its interpretation with consideration of subchapter V’s “juxtaposition in Chapter 11 with traditional Chapter 11 provisions, reflecting its distinctive purpose within that Chapter.”²⁸⁹ The court observed that a primary goal of subchapter V is to simplify chapter 11 for small businesses and to reduce administrative costs for them. To do so, the court said, “Congress deliberately altered the general provisions of traditional Chapter 11 proceedings by, among other things, eliminating the absolute priority rule and limiting the applicability of [§ 1141\(d\)](#) to Subchapter V proceedings.”²⁹⁰

The Fourth Circuit followed this statement with three sentences dealing with discharge provisions. The sentences, with commentary, are:

1. “[Section 1141\(d\)](#), in particular, sets forth debts that are eligible for discharge in a traditional Chapter 11 proceeding, making distinctions between individual debtors and corporate debtors.”²⁹¹

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Specifically, § 1141(d)(1)(A) describes the debts that are discharged, and § 1141(d)(2) states that the discharge does not discharge an individual debtor from any debt excepted from discharge under § 523.²⁹² The distinction reflects the simple proposition that an individual should not be able to use chapter 11 to obtain benefits that are not available in other chapters.²⁹³

2. “In contrast, § 1192 provides benefits to small business debtors, regardless of whether they are individuals or corporations.”²⁹⁴

This correctly states the operation of § 1192 as the court interpreted it. But whether the benefits are or should be the *same* with regard to exceptions to discharge is the issue before the court. Logic does not permit a premise that is the result of the reasoning.

3. “Thus, an important purpose for Subchapter V would be frustrated were we to adopt [the bankruptcy court’s] interpretation of §§ 1192(2) and 523(a), which would treat individuals and corporations differently.”²⁹⁵

This conclusion raises two questions. What is the “important purpose” for subchapter V that concerns the court? How is it frustrated by different provisions for the discharge of debts?

The Fourth Circuit’s opinion states earlier that Congress enacted subchapter V “with the primary goal of simplifying Chapter 11 reorganizations for small businesses and reducing the administrative costs for those businesses.”²⁹⁶ This is the universally recognized objective of subchapter V.

But if this is the “important purpose,” making a corporation’s discharge subject to exceptions frustrates, rather than furthers, that purpose. As earlier text explains,²⁹⁷ Congress chose to eliminate exceptions to corporate discharge when it enacted chapter 11 in 1978 because they are an impediment to reorganization.²⁹⁸ The fact that a subchapter V debtor has less debt than a traditional chapter 11 corporation does not change this reality. Exceptions to discharge in a subchapter V case do not simplify reorganization or reduce its costs. To the contrary, they significantly complicate it and can make it impossible.²⁹⁹

The implication of the Fourth Circuit’s reasoning, however, is that the court considers the “important purpose” to be that the same discharge exceptions in § 1192(2) apply to individuals and corporations alike. If so, a ruling that different exceptions apply to entities obviously frustrates that purpose.

Again, however, whether § 1192(2) makes a distinction is the issue before the court. The Fourth Circuit is deciding that the same treatment is an important purpose, but the fact that its ruling *has* that result does not provide a reason *why* that should be the result or why the same treatment is important. In other words, logic requires that a conclusion that an important purpose of § 1192 is identical treatment of individuals and corporations rest on something more than the determination that § 1192 has that result.

Proper analysis seeks to determine the purpose of § 1192 by reference to the purpose of subchapter V, which is to make it easier for a smaller business to reorganize. As the next section explains, and as the Congressional policy choice of an exceptionless discharge for corporations recognizes,³⁰⁰ exceptions to the discharge of a corporation hinder that purpose.

7. “Equity and fairness” and elimination of the absolute priority rule

The Fourth Circuit in *Cleary Packaging*³⁰¹ also supported its decision based on considerations of “equity and fairness” arising from the elimination of the absolute priority rule. The court reasoned that, without the absolute priority rule, a corporation’s owners can retain their ownership interest “at the expense of and over the objection of creditors.”³⁰² The Fourth Circuit reasoned that Congress expanded discharge exceptions to subchapter V entities to offset this consequence of removal of the absolute priority rule.

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Subchapter V enacted provisions to protect creditors to substitute for the absolute priority rule, but the protections are the projected disposable income requirement³⁰³ and heightened feasibility standards³⁰⁴ as part of the cramdown requirement that a plan be “fair and equitable.”³⁰⁵

Discussion of the Fourth Circuit's analysis of subchapter V's juxtaposition with traditional chapter 11 provisions and its related consideration of fairness and equity requires a review of related economic and legal issues that the business reorganization of a corporation presents, including the operation and effect of the absolute priority rule, its elimination in subchapter V cases, and the discharge of a corporation.

a. Review of reorganization, absolute priority rule, and exception to discharge principles

A reorganization case under any chapter involves two basic economic issues that inform analysis of confirmation and discharge matters. The first is how much money the debtor can generate to pay creditors. The second is how that money is allocated among them. Bankruptcy principles require allocation to pay the value of secured claims, to pay administrative and priority claims in full, and to pay unsecured creditors what is left. A fundamental principle is equal treatment of similarly situated creditors.

Theoretically, the amount that a corporation can pay is unlimited: it can just keep making payments until everyone is paid in full. In the meantime, however, the corporation has a financial structure that makes no sense because it remains insolvent, and equity has no prospect of any return for the time it takes to pay its debts in full.

Reorganization solves a *corporation's* financial structure by restructuring the balance sheet to reduce debt to a manageable amount. If the proposed restructuring is unacceptable to a class of unsecured creditors, the theory of the absolute priority rule is that the reorganized corporation's value is then allocated among its stakeholders—creditors and owners—in accordance with their priorities.³⁰⁶ Because creditors have priority over owners, creditors under the absolute priority rule receive the ownership interests to the exclusion of existing owners, except in the rare instance where the reorganized corporation is worth more than the amount of the debt.

Reorganization under these principles does not work if the reorganized corporation remains liable for a nondischargeable debt, as Section III(C)(1) explains. As Section III(C)(1) also explains, and as the bankruptcy court in *Cleary Packaging* recognized, Congress enacted chapter 11 in 1978 with no exceptions to the discharge of a corporation's debts because *any* corporate discharge exception “would leave an undesirable uncertainty surrounding reorganizations that is unacceptable.”³⁰⁷

The existence of nondischargeable debts of a corporation is related to the basic economic questions of how much a debtor can pay and how it is allocated. If the nondischargeable debt is large enough that the debtor cannot generate enough money to pay it within a reasonable time, reorganization is not possible. If reorganization is possible, the need to pay the nondischargeable debt in full affects the allocation of the money available to pay other debts.

The absolute priority rule is only tangentially related to the question of what the debtor can pay. It does not apply if what the debtor can pay is enough to be acceptable to the class of unsecured creditors so that their acceptance makes it inapplicable. It is not related at all to the allocation of available money among creditors. The absolute priority rule, rather, involves allocation of the debtor's value between creditors and owners.

What the absolute priority rule affects is the ability of a debtor, especially a smaller business, to reorganize.

In one sense, ownership interests in an insolvent corporation have no value because the corporation's debts exceed its assets. If a reorganization plan obligates the debtor to pay creditors an amount for pro rata distribution equal to the net liquidation value of the company (i.e., the value of the debtor as a going concern less the amount of secured and priority debt), the reorganized debtor has a net worth of zero. Creditors arguably lose nothing if existing owners retain ownership interests that have no value.

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Absolute priority rule principles, however, prescribe value to ownership interests in an insolvent corporation and require that, in the absence of payment in full, the creditors become the owners of the reorganized debtor even in the circumstances just described unless—as a class—they accept a plan that provides otherwise.

Creditor ownership of a publicly traded corporation is one thing. Creditor ownership of a private smaller business is another. It is unlikely that a market for the equity interests in a privately held business will exist. Creditors typically are not interested in holding a minority interest in a private company that they cannot readily turn into cash.

Moreover, the owners of a small business are usually its managers. In many instances, the value of a smaller business depends on the services that they provide.³⁰⁸ If reorganization means that they will lose their ownership interests, they may elect not to pursue reorganization in the first place. And if they do but are unable to restructure without retaining ownership, they may well abandon the effort or let the creditors as the new owners manage the business.

These real-life considerations are the bases for elimination of the absolute priority rule in corporate cases under subchapter V. Simply put, its elimination permits the reorganization of smaller businesses that would otherwise not be possible or even attempted.

In accordance with the underlying premises of the absolute priority rule that equity in an insolvent corporation has value and that creditors are its equitable owners, subchapter V substitutes the projected disposable income requirement for it.³⁰⁹ At bottom, the value of a corporation is its earning capacity. Instead of giving creditors the right to own the corporation if they reject the plan, subchapter V gives them its earnings for a period of three to five years, as the court determines. As such, it turns the ownership interest that unsecured creditors could otherwise claim under the absolute priority rule into cash in a way that could not be accomplished under the absolute priority rule in a smaller business context.

b. Analysis of the Fourth Circuit's “fairness and equity” rationale

The Fourth Circuit concluded in *Cleary Packaging*³¹⁰ that considerations of fairness and equity require exceptions to a corporation's discharge in view of elimination of the absolute priority rule.

The Fourth Circuit's consideration of equity and fairness and its analysis of the exceptions to discharge in connection with the elimination of the absolute priority rule began with the premise that elimination of the absolute priority rule allows a corporation's owners to retain their ownership interests “at the expense of and over the objection of creditors.”³¹¹

The court's premise is partially correct. It is true that elimination of the absolute priority rule means that a *class* of creditors in a subchapter V case no longer has the ability to insist on full payment as a condition of the owners' retention of their interests. But a *single* creditor never had the right to invoke the absolute priority rule unless its claim was large enough to control the class vote.

Elimination of the absolute priority rule in subchapter V cases does not necessarily mean that owners retain their interests “at the expense” of creditors. In a subchapter V case, as earlier text discusses, ownership interests in the debtor are likely to have no realizable value. Reorganization usually depends on continued management by existing owners and therefore requires their retention of ownership. The liquidation value of assets is often less than the amount of debt that the assets secure. Retention of ownership interests that have no realizable value hardly comes at the expense of creditors.

Moreover, subchapter V imposes a projected disposable income requirement for cramdown confirmation³¹² as a substitute for the absolute priority rule.³¹³ It requires the commitment of projected disposable income for a period of three to five years, as the court determines.

In its consideration of fairness and equity, the Fourth Circuit connected elimination of the absolute priority rule to exceptions to a corporation's discharge and concluded that treating a corporation's discharge differently from an individual's would (1)

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undermine the balance of elimination of the absolute priority rule by adding an additional layer of fairness and equity; (2) make no sense; and (3) create perverse incentives.³¹⁴

The connection of discharge exceptions to elimination of the absolute priority rule is not an appropriate one, and exceptions to discharge do not add an additional layer of fairness and equity for creditors.

Recall that the absolute priority rule is a requirement in traditional cases that unsecured creditors may invoke collectively if their class rejects that plan. A creditor cannot invoke it on its own behalf if its class of creditors accepts the plan. It protects classes of creditors, not a specific creditor.

In contrast, nondischargeable debt involves only the creditor who holds it. Nondischargeability of a creditor's debt may improve *that* creditor's position, but it provides no benefits to *other* creditors.

Limitations on dischargeability of debts that favor some creditors does not balance the elimination of the absolute priority rule that affects all creditors. The projected disposable income requirement serves that balancing function.

Moreover, elimination of distinctions between individuals and entities for the exception of debts from discharge cannot possibly add an “additional layer of fairness and equity” for any creditors except those with nondischargeable debts. Nondischargeability of a particular debt does not affect determination of the debtor's projected disposable income—the key determinant of how much the debtor must pay unsecured creditors. All it does is leave the debtor with an obligation to pay the nondischargeable debt because it cannot restructure it.

Indeed, the existence of a nondischargeable debt in a reorganization case is in most circumstances adverse to the interests of unsecured creditors generally.

First, it results in competition for available funds between unsecured creditors with dischargeable debts and those with nondischargeable debts. In general, any chapter 11 plan (including all subchapter V plans, whether consensual or cramdown) must treat similarly situated creditors the same. The fact that a debt is nondischargeable presumably will not increase the pro rata share of projected disposable income its holder receives in a subchapter V case.³¹⁵ At best, the plan may be able to deal with the nondischargeable debt by payment of the remaining balance (after application of the pro rata share of projected disposable income, or “PDI”) in payments that begin when the period for payment of PDI ends.

This situation creates an incentive for a debtor to minimize payments to creditors with dischargeable debts. Every dollar not paid to creditors generally is a dollar that is available to pay the nondischargeable debt. Conversely, every dollar paid on the nondischargeable debt in excess of a pro rata share of disposable income is a dollar that is not paid to unsecured creditors generally.

Second, the existence of nondischargeable debt increases the probability of liquidation. When a feasible plan is otherwise possible, liquidation generally results in a lower recovery for unsecured creditors than payments under a plan.

To the extent that application of exceptions to discharge in subchapter V affects any balance, it tips the scale in favor of the creditor whose debt is excepted from discharge and against creditors whose debts are not dischargeable.

The Fourth Circuit did not elaborate on its observations that the discharge of a corporation's debts with no exceptions “would make no sense and indeed would create perverse incentives.” As earlier text explains, a discharge without exceptions furthers the prospects for a successful reorganization and results in equality of treatment for creditors in a traditional case. These reasons prompted Congress' policy decision to eliminate exceptions to the discharge of a corporation when it enacted chapter 11 in 1978.³¹⁶

A subchapter V case is no different. Depending on the amount of a nondischargeable debt, its existence is likely to doom reorganization of a smaller business and result in its liquidation.

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A subchapter V debtor may be able to manage nondischargeable debts if, collectively, they are relatively immaterial in relation to its total debts. For example, assume a debtor with \$300,000 of unsecured debt that will pay \$75,000 in projected disposable income over three years to unsecured creditors—a 25 percent distribution.

This debtor could probably pay a nondischargeable debt of, say, \$50,000. The debtor could pay the unpaid balance of \$37,500 by continuing PDI payments at the same level for an additional year and a half. Owners may elect to pursue reorganization in this situation, reasoning that retention of ownership rather than liquidation is worth the additional cost.

On the other hand, it is arguable that this debtor should be required to pay projected disposable income to creditors for five years rather than three, thereby increasing what creditors receive. The additional money that unsecured creditors receive is money that would otherwise be paid on the nondischargeable debt, so it increases the cost of the reorganization from the owners' standpoint. At some point, owners will decide that it is better for them to start over in other employment or a new venture rather than devote the fruits of their efforts to payment of debt.

In contrast, assume that a debtor has \$5 million in unsecured debt, including a nondischargeable judgment of \$4.7 million, and projected disposable income over five years of \$280,000.³¹⁷ Creditors receive a distribution of about 5.6 percent, and the nondischargeable debt is reduced to about \$4,436,800. It would take this debtor over 16 years to pay the rest of the nondischargeable debt based on its currently projected income. It is not realistic to expect that owners will sign on for this type of work.³¹⁸ Liquidation is inevitable.

For creditors with the objective of putting the debtor out of business, liquidation is a welcome result. It is a disaster for owners who have invested their time and money in the business, and it adversely affects employees who lose their jobs, customers who rely on the business, and creditors who will be paid less (and often nothing) when liquidation occurs.

The same result can occur with regard to relatively small nondischargeable debts if there are enough of them. Further, once a creditor's strategy of asserting a nondischargeable debt succeeds, the predictable result is that more creditors will assert such claims. Indeed, creditors will have a significant incentive to do so. As Professor Brubaker observed in his work,³¹⁹ as noted earlier in this article, the existence of exceptions to a corporate discharge in the chapter XI context “supplied, to any creditor who could assert colorable allegations of fraud, a credible threat to ‘opt out’ of the chapter XI restructuring, in an attempt to receive a greater recovery than other creditors.”³²⁰ Further, a debtor must defend even meritless claims, increasing administrative expenses and, necessarily, what creditors receive.

In summary, the Fourth Circuit's conclusion that discharge of a subchapter V corporation without exceptions would “make no sense” and “create perverse incentives” does not withstand careful scrutiny.

The availability of exceptions to a corporation's discharge threatens the ability of a debtor to reorganize. It encourages the assertion and prosecution of exceptions to discharge, resulting in litigation that requires time that could otherwise be devoted to reorganization efforts and money for attorney's fees and expenses that would otherwise be available for creditors.

Moreover, if the result of a nondischargeable judgment is liquidation, the nondischargeable debt receives only its pro rata share of any net proceeds of liquidation. Anecdotal experience teaches that the liquidation of a small business most often results in pennies on the dollar for unsecured creditors and, in many cases, nothing at all.³²¹ The entire nondischargeability dispute becomes meaningless.

Considerations of fairness and equity favor the discharge of a corporation after cramdown discharge that is not subject to exceptions under § 523(a).

VI. Conclusion

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If a public opinion survey asked, “Should a company be able to use bankruptcy reorganization laws to stay in business without full payment of its liabilities for fraud or other misconduct?”, most people would probably answer “No.” The response reflects the Fourth Circuit’s concern in *Cleary Packaging* that a corporate subchapter V debtor should not benefit from a discharge of debts “incurred in circumstances of fraud, willful and malicious injury, and the other violations of public policy listed in § 523(a)’s list of exceptions.”³²² More generally, it is consistent with the classic formulation of the “fresh start” policy of the bankruptcy laws that bankruptcy relief is for the “honest but unfortunate debtor.”³²³

This framing of the survey question, however, does not take into account all of the complexities and nuances that consideration of exceptions to the discharge of a corporation in a reorganization case requires. The question implies that a reorganization will occur and that the issue is simply whether the reorganized debtor must pay its fraud and other excepted debts in full on the assumption that it will be able to do so.

The realities of corporate reorganization are different. Congress recognized this in 1978, when it legislated corporate chapter 11 discharges without exceptions. The better statutory reading of SBRA, as set forth above, is that Congress recognized this again in 2019 when it enacted Subchapter V of chapter 11. Discharge without exceptions is essential for the reorganization of a corporation, rather than its liquidation, in accordance with chapter 11’s creditor equality principles that require equal treatment of similarly situated creditors.³²⁴ The existence of exceptions to discharge impedes reorganization and makes it more likely that liquidation will occur.

If reorganization fails and liquidation occurs, the creditor with an excepted debt will receive only its pro rata share of the proceeds from liquidation after satisfaction of secured claims, administrative claims, and priority claims. Most businesses are worth more when operating and reorganized than liquidated. The recovery for unsecured creditors upon liquidation is typically much less than recovery under a plan, and often nothing at all.³²⁵

Excepting a debt from discharge, therefore, does not mean that it will be paid in full. The more likely result is that all creditors will receive much less.

The inclusion of appropriate premises in the survey question would result in a different formulation of the question:

Which way should the amount that a reorganized company must pay under the bankruptcy laws to its unsecured creditors be allocated between debts based on the company’s fraud or other misconduct and other debts:

- (1) The money should be allocated to pay the fraud and other debts in full, with other creditors receiving what is left.
- (2) The money should be paid to all creditors on a pro rata basis.

A follow-up question would ask:

If requiring a company to pay its fraud and other debts in full will make reorganization impossible and will result in liquidation of the company and payment of less money to creditors on a pro rata basis (or perhaps no money at all), should the company be permitted to pay all of the debts on the same pro rata basis?

These are the questions that Congress answered when it enacted chapter 11 in the Bankruptcy Reform Act of 1978. The intentional Congressional policy choice was enactment of an exceptionless corporate discharge to eliminate the problems that

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a discharge with exceptions posed under the former chapter XI and to improve the prospects for a successful reorganization for the benefit of all creditors as well as others such as employees, vendors, and customers.³²⁶

Congress chose an exceptionless discharge for corporations in chapter 11 cases even though it is inconsistent with the “fresh start” policy of the Bankruptcy Code that limits bankruptcy relief to the “honest but unfortunate” debtor.³²⁷ The reason is that a corporation's discharge in a reorganization case serves a different function than the “fresh start” discharge that an individual receives. Discharge of a corporation without exceptions rests on the need for finality of a confirmed plan and is essential for the reorganization of a corporation, rather than its liquidation, in accordance with chapter 11's creditor equality principles that require equal treatment of similarly situated creditors.³²⁸

The question is whether Congress did something different in subchapter V when it modified some of the provisions of chapter 11 to enhance the ability of a smaller debtor to reorganize its business. Because Congress made no change when the debtor receives a discharge after consensual confirmation, the specific issue is whether it intended to change the policy of an exceptionless discharge for a corporation when it receives a cramdown discharge in a subchapter V case.

The bankruptcy courts and the Ninth Circuit Bankruptcy Appellate Panel concluded that the plain meaning of § 1192(2) and the amended preamble of § 523(a) requires an interpretation that the § 523(a) exceptions do not apply to the discharge of a corporation after cramdown confirmation, because § 1192(2) excepts “debts of the kind” specified in § 523(a), which are only debts of individuals.³²⁹ The Fourth Circuit in *Cleary Packaging*³³⁰ ruled that the exceptions apply because § 1192(2) refers to the kind of *debt* listed in § 523(a), not the kind of *debtor*.

The textual interpretation of the bankruptcy courts is the better one. But if both interpretations of the texts are plausible, as the Fourth Circuit acknowledged in *Cleary Packaging*³³¹ in describing the question as a “close one,”³³² other indicia of Congressional intent and purpose necessary to interpretation of the statute³³³ require the same conclusion.

It is undisputed that, in enacting the Bankruptcy Code in 1978, Congress intentionally and carefully chose an exceptionless discharge for a corporation in a chapter 11 case for the purpose of eliminating obstacles to corporate reorganization.³³⁴ It is undisputed that the purpose of subchapter V is to enhance the prospects for reorganization of a smaller business.³³⁵ The inescapable conclusion is that, in the process of making reorganization easier for smaller businesses, Congress did not intend to change the existing chapter 11 law of exceptionless discharges³³⁶ or complicate the reorganization of a smaller business contrary to the purpose of subchapter V³³⁷ by imposing exceptions to discharge that do not exist in non-subchapter V cases.³³⁸

The legislative history of subchapter V compels this conclusion.³³⁹ The Report of the Judiciary Committee of the House of Representatives states only that the § 1192 discharge excepts debts on which the last payment is due after the commitment period under the plan and “any debt that is otherwise nondischargeable,”³⁴⁰ a logical reference to § 523(a), which applies only to individuals. If Congress had intended a drastic change to the discharge of a corporation by making it subject to § 523(a) exceptions, one would expect the Report to point it out, but it says nothing else about the discharge.

As the bankruptcy court in *Cleary Packaging* aptly observed, Congress does not “hide elephants in mouseholes.”³⁴¹ In any event, the legislative history reveals no indication that Congress intended to depart from the existing practice of exceptionless discharges for a chapter 11 corporation.

The Congressional policy of exceptionless discharges for corporations recognizes practical realities that may be even more important in the case of a subchapter V debtor.

Creditors with little or no basis for asserting a nondischargeable claim may be tempted to prosecute a nondischargeable claim in order to obtain leverage and more favorable treatment in the case because the debtor will have to settle to avoid legal

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fees. Defense costs could drain necessary cash away from necessary business expenditures and, in any event, would increase administrative costs and necessarily reduce the amount of money available to pay creditors.³⁴²

Reorganization of a corporation in a subchapter V case requires a discharge that is not subject to exceptions. The interpretation of § 1192(2) as providing for no exceptions to the discharge of a corporation after cramdown confirmation is required by the enacted statutory text, enhances the prospects for reorganization of subchapter V debtors and furthers subchapter V's purpose.

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Footnotes

- * Paul W. Bonapfel serves as a United States Bankruptcy Judge for the Northern District of Georgia.
- ** Robert Schaaf is a law clerk for the Bankruptcy Court for the Northern District of Georgia.
- 1 [11 U.S.C.A. § 523\(a\)](#). [Section 523](#) lists certain types of debt excepted from the discharge granted under §§ 727 (chapter 7 discharge), 1141 (chapter 11 and subchapter V discharges after § 1191(a) confirmation), 1192 (subchapter V discharge after § 1191(b) confirmation), 1228(a) (chapter 12 discharge after completion of payments), 1228(b) (chapter 12 “hardship” discharge), or 1328(b) (chapter 13 “hardship” discharge). [Section 523\(a\)](#) excepts 21 categories of debt including (but not limited to) debts obtained for fraud, debts for domestic support obligations, debts for willful and malicious injuries, student loan debt, and debts for death or personal injury from a debtor's drunk driving. [11 U.S.C.A. § 523\(a\) \(4\), \(5\), \(6\), \(8\), and \(9\)](#).
- 2 “Corporation” is a defined term in the Bankruptcy Code, [11 U.S.C.A. § 101\(9\)](#), and includes, among other things, a limited liability company, but does not include a partnership. E.g., 2 COLLIER ON BANKRUPTCY ¶ 101.09 (16th ed. 2023). This Article uses “corporation” more colloquially to include any entity that is not an individual.
- 3 Congress enacted subchapter V in the Small Business Reorganization Act of 2019, [Pub. L. No. 116-54, 133 Stat. 1079](#) (codified in [11 U.S.C.A. §§ 1181](#) to [1195](#) and scattered sections of 11 U.S.C.A. and 28 U.S.C.A.).
- 4 In a non-subchapter V case, § 1129(a) provides for confirmation of a plan if all of its requirements are met. The requirements include acceptance by all impaired classes of claims and interests. [11 U.S.C.A. § 1129\(a\)\(8\)](#). Confirmation of a plan when all impaired classes accept it is called “consensual confirmation” because all the classes have agreed to it. Dissenters may exist within each class, because a class accepts if more than half in number holding at least two-thirds in dollar amount who voted accepted the plan. [11 U.S.C.A. § 1126\(c\)](#).

[Section 1129\(b\)](#) permits confirmation in a non-subchapter V case if one or more impaired classes does not accept the plan if the plan meets all the other applicable requirements in [§ 1129\(a\)](#) and the plan meets the requirements of [§ 1129\(b\)](#). [11 U.S.C.A. § 1129\(b\)\(1\)](#). “Cramdown” is a colloquial term that describes this type of confirmation. The term reflects the fact that the court may “cram down” the provisions of the plan on the rejecting class over its opposition.

Subchapter V also provides for consensual and cramdown plan confirmation. Section 1191(a) provides for consensual confirmation if all of the requirements of [§ 1129\(a\)](#) are met except the projected disposable income requirement in [§ 1129\(a\)\(15\)](#) that applies only to individuals.

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The cramdown requirements of [§ 1129\(b\)](#) do not apply in a subchapter V case. [11 U.S.C.A. § 1181\(a\)](#). Instead, § 1191(b) states the requirements for cramdown confirmation when one or more impaired classes do not accept the plan.

Section II(C) summarizes the cramdown requirements of [§ 1129\(b\)](#) and [§ 1191\(b\)](#), respectively.

5

The kind of discharge received by a subchapter V debtor on plan confirmation depends on whether discharge occurs after consensual confirmation or cramdown confirmation. See supra note 4. If consensual confirmation occurs under [§ 1191\(a\)](#), the debtor receives a discharge under § 1141(d), except that provisions applicable to the discharge of an individual in § 1141(d)(5) do not apply under [11 U.S.C.A. § 1181\(a\)](#). If cramdown confirmation occurs, the debtor receives a discharge under § 1192, and § 1141(d) does not apply except as § 1192 provides. [11 U.S.C.A. § 1181\(c\)](#).

In a non-subchapter V case, by comparison, the debtor receives a discharge under § 1141(d), regardless of whether confirmation is consensual or cramdown.

Though most chapter 11 cases are filed by corporations, an individual also can file. A § 1141(d) discharge of a corporation is not subject to the exceptions in [§ 523\(a\)](#), but the § 1141(d) discharge of an individual is. [11 U.S.C.A. § 1141\(d\)\(2\)](#). A § 1192 discharge is subject to exceptions for debts “of the kind specified” in [§ 523\(a\)](#). It is clear that the [§ 523\(a\)](#) exceptions apply to an individual.

Thus, the [§ 523\(a\)](#) exceptions always apply to the discharge of an individual. But they do not apply to the discharge of a corporation under [§ 1141\(d\)](#), which a corporation receives in any non-subchapter V case (regardless of the type of confirmation) and in a subchapter V case after consensual confirmation. The issue under consideration here, therefore, exists only when a corporation receives a discharge in a subchapter V case after cramdown confirmation.

6

[In re Off-Spec Solutions, LLC](#), 651 B.R. 862 (B.A.P. 9th Cir. 2023), notice of appeal filed, No. 23-60034 (9th Cir., July 20, 2023); [In re 2 Monkey Trading, LLC](#), 650 B.R. 521, 72 Bankr. Ct. Dec. (CRR) 132 (Bankr. M.D. Fla. 2023), notice of appeal filed, No. 23-12342 (11th Cir., July 19, 2023); [In re Hall](#), 651 B.R. 62 (Bankr. M.D. Fla. 2023), [In re GFS Industries, LLC](#), 647 B.R. 337 (Bankr. W.D. Tex. 2022), notice of appeal filed, No. 23-60034 (5th Cir., April 7, 2023); [In re Lapeer Aviation, Inc.](#), 71 Bankr. Ct. Dec. (CRR) 112, 2022 WL 1110072, at *2 (Bankr. E.D. Mich. 2022); [In re Rtech Fabrications, LLC](#), 635 B.R. 559, 565 (Bankr. D. Idaho 2021); [In re Cleary Packaging LLC](#), 630 B.R. 466, 472, 70 Bankr. Ct. Dec. (CRR) 112 (Bankr. D. Md. 2021), rev'd and remanded, 36 F.4th 509, 515 (4th Cir. 2022); [In re Satellite Restaurants Inc. Crabcake Factory USA](#), 626 B.R. 871, 878, 70 Bankr. Ct. Dec. (CRR) 12 (Bankr. D. Md. 2021). Two bankruptcy courts reached the opposite conclusion in unreported decisions. [In re Duntov Motor Co., LLC](#) (Bankr. N.D. Tex. Aug. 26, 2021) No. 21-40348-MXM-11, ECF No. 27; [Sun City Truck Sales v. Tonka Int'l. Corp.](#) (In re Tonka Int'l. Corp.) (Bankr. E.D. Tex. Sept. 16, 2020) 20-4064-BTR, ECF No. 15. Another bankruptcy court ruled that a judgment for patent infringement against a corporation in a subchapter V case was excepted from discharge under [§ 523\(a\)\(6\)](#) as a willful and malicious injury without addressing whether [§ 523\(a\)](#) exceptions apply to the discharge of a corporation or citing the applicable subchapter V discharge provision, [11 U.S.C.A. § 1192\(2\)](#). [In re Better Than Logs, Inc.](#), 631 B.R. 670, 688–89 (Bankr. D. Mont. 2021).

7

[In re Cleary Packaging, LLC](#), 36 F.4th 509 (4th Cir. 2022).

8

[11 U.S.C.A. § 1192\(2\)](#).

9

Small Business Reorganization Act (SBRA) of 2019, [Pub. L. No. 116-54](#), sec. 4(a)(8), 133 Stat. 1079 (codified in [11 U.S.C.A. § 523\(a\)](#)).

10

[11 U.S.C.A. 523\(a\)](#) (emphasis added). The law generally defines an “individual” to be a natural person. The Bankruptcy Code does not contain a specific definition of the term. The Code, though, in numerous provisions draws a clear distinction between an “individual” and a “corporation” (see e.g., [11 U.S.C.A.](#)

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§ 101(9), (18)(A), (19A), (31), and (41)), or uses the term “individual,” which by context indicates that the term refers to a natural person (see e.g., 11 U.S.C.A. § 101(8), (18), (19A)(A), (40A), (41A), (44), and (45)).

11

See, e.g., H.R. REP. NO. 116-171 at 4 (2019), as reprinted in 2019 U.S.C.C.A.N. 366, 369 (“[S]mall business chapter 11 cases continue to encounter difficulty in successfully reorganizing.”); American Bankruptcy Institute Commission to Study the Reform of Chapter 11: 2012–14 Final Report & Recommendations, 23 AMER. BANKR. INST. L. REV. 1, 300–02, 324 (2015) (For many small or medium-sized businesses, “the common result of plan confirmation extinguishing pre-petition equity interests in their entirety [is] unsatisfactory or completely unworkable.”).

Several witnesses testified to the unworkability of chapter 11 for smaller businesses at the congressional hearings that preceded the passage of the SBRA. See Oversight of Bankruptcy Law and Legislative Proposals: Hearing Before the Subcomm. on Antitrust, Com. & Admin. L. of the H. Comm. on the Judiciary, 116th Cong. 19–22 (2019) [Senate 2019 Sub V Hearing] (statement of Rep. Ben Cline, Member, H. Comm. on the Judiciary); Senate 2019 Sub V Hearing at 114, 116 (Testimony of A. Thomas Small, Retired Bankruptcy Judge, on behalf of the National Bankruptcy Conference); Senate 2019 Sub V Hearing at 38–39 (Letter submitted by Marc A. Levenson and Mark D. Bloom on behalf of the American College of Bankruptcy) (2019).

Robert J. Keach provided the following testimony on behalf of the American Bankruptcy Institute:

Chapter 11 doesn't work for small and medium-sized businesses because the Bankruptcy Code (a) places unrealistic and artificial deadlines on small and medium-sized businesses, which do not give these companies an opportunity to restructure; (b) imposes substantial and costly disclosure and reporting requirements on these companies; (c) does not provide any tools that can help small businesses—whose owners may be unsophisticated in finance, business plans, or restructuring issues—create and implement an effective reorganization plan; and (d) makes it difficult for a small business owner to maintain an ownership interest in the business under the current Chapter 11.

Senate 2019 Sub V Hearing at 52–53 (Testimony of Robert J. Keach, co-chair, Commission to Study the Reform of Chapter 11, American Bankruptcy Institute).

12

A “small business debtor” as defined in 11 U.S.C.A. § 101(51D) is in a “small business case” under 11 U.S.C.A. § 101(51C) unless it elects application of subchapter V. For a summary of small business reorganizations under the Bankruptcy Code, see Ralph Brubaker, The Small Business Reorganization Act of 2019, 39 No. 10 BANKRUPTCY LAW LETTER 1 (October 2019); Paul W. Bonapfel, A Guide to the Small Business Reorganization Act of 2019 [Bonapfel, A Guide to the SBRA], at 156–60 (rev. ed. June 2022), available at https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf.

13

Small Business Reorganization Act of 2019 (“SBRA”), Pub. L. No. 116-54, 133 Stat. 1079 (codified in 11 U.S.C.A. §§ 1181 to 1195 and scattered sections of 11 U.S.C.A. and 28 U.S.C.A.).

14

H.R. REP. NO. 116-171, at 1 (2019), as reprinted in 2019 U.S.C.A.C.A.N. 366, 366.

15

H.R. REP. NO. 116-171, at 4 (2019), as reprinted in 2019 U.S.C.C.A.N. 366, 369 (citing Oversight of Bankruptcy Law and Legislative Proposals: Hearing Before the Subcomm. on Antitrust, Com. & Admin. L. of the H. Comm. on the Judiciary, 116th Cong. 23 (2019) (statement of Rep. Ben Cline, Member, H. Comm. on the Judiciary)). The court in *In re Progressive Solutions, Inc.*, reviewed the legislative progress of SBRA and included public statements from several cosponsors of the law, including Senators

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Charles Grassley, Sheldon Whitehouse, Amy Klobuchar, Joni Ernst, and Richard Blumenthal. [In re Progressive Solutions, Inc.](#), 615 B.R. 894, 896–98 (Bankr. C.D. Cal. 2020) (quoting Press Release, Chuck Grassley, Member, Senate Judiciary Committee, Grassley, Bipartisan Colleagues Introduce Legislation to Help Small Businesses Restructure Debt (Apr. 9, 2019), <https://www.grassley.senate.gov/news/news-releases/grassley-bipartisan-colleagues-introduce-legislation-help-small-businesses-0>); see also Michael C. Blackmon, [Revising the Debt Limit for “Small Business Debtors”: The Legislative Half-Measure of the Small Business Reorganization Act](#), 14 BROOK. J. CORP. FIN. & COM. L. 339, 344–45 (2020).

¹⁶ See generally Bonapfel, A Guide to the SBRA at 1-7, (rev. ed. June 2022), available at https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf. SBRA also made conforming amendments to statutes in title 28 of the United States Code dealing with appointment and compensation of trustees and quarterly fees. See Paul W. Bonapfel, A Guide to the SBRA at 1-7, app. A.

¹⁷ [11 U.S.C.A. § 103\(i\)](#). Infra note 19 discusses the operation of [§ 103\(i\)](#) in connection with determination of eligibility for subchapter V.

¹⁸ A debtor who meets the definition of “small business debtor” in [§ 101\(51D\)](#) is in a “small business case,” as defined in [11 U.S.C.A. § 101\(51C\)](#). Except for the amount of the debt limit, the definition of a “small business debtor” is the same as the definition of a debtor eligible for subchapter V under current law in [§ 1182\(1\)](#). See infra note 19.

¹⁹ As originally enacted, SBRA added [11 U.S.C.A. § 103\(i\)](#) to provide for application of subchapter V to a “small business debtor” who elected its application. Small Business Reorganization Act (SBRA) of 2019, [Pub. L. No. 116-54](#), sec. 4(a)(2), 133 Stat. 1079, 1085 (codified as amended in [11 U.S.C.A. § 103\(i\)](#)). The SBRA also amended the definition of “small business debtor” in [11 U.S.C.A. § 101\(51D\)](#). SBRA supra at sec. 4(a)(1)(A)–(B), 133 Stat. at 1085. The text summarizes the requirements for qualification as a “small business debtor” under amended [§ 101\(51D\)](#) that thus determined eligibility for subchapter V, except that the original debt limit was \$2,500,000. A small business debtor who did not elect subchapter V was in a “small business case” under [§ 101\(51C\)](#). For a discussion of the original eligibility statute, see Paul W. Bonapfel, [A Guide to the SBRA](#), 93 AM. BANKR. L. J. 571, 580–82 (2019).

Temporary legislation, applicable until June 20, 2024, increased the debt limit for a subchapter V debtor to \$7,500,000 and amended [§§ 103\(i\)](#) and [1182\(1\)](#) so that [§ 1182\(1\)](#) states the eligibility requirements for subchapter V until June 20, 2024. Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), [Pub. L. No. 116-136](#), sec. 1113(a), 134 Stat. 281, 310 (2020) (codified as amended in [11 U.S.C.A. § 1182](#)) (increasing debt limit to \$7.5 million for one year); COVID-19 Bankruptcy Relief Extension Act of 2021, [Pub. L. No. 117-5](#), secs. 2(d), 2(i)(B), 135 Stat. 249 (2021) (codified as amended in [11 U.S.C.A. § 1182](#)) (extending debt limit for additional year); Bankruptcy Threshold Adjustments and Technical Corrections Act, [Pub. L. No. 117-151](#), sec. 2(i)(1), 136 Stat. 1298, 1300 (2022) (codified as amended in [11 U.S.C.A. § 1182\(1\)](#)) (extending debt limit to June 20, 2024). For a discussion of how the legislation temporarily increased the debt limit and amended eligibility requirements, see Bonapfel, A Guide to the SBRA, supra note 12, at 17–24, 46–48, 257–74 (rev. ed. June 2022), available at https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf. The debt limit for a small business debtor did not change. After adjustment for inflation under [11 U.S.C.A. § 104](#) (which provides for adjustment of certain dollar amounts stated in the Bankruptcy Code every three years), the debt limit for a small business debtor in [§ 101\(51D\)](#) is \$3,024,725 as of April 1, 2022, the last time the inflation adjustments occurred. [Adjustments of Certain Dollar Amounts in the Bankruptcy Code](#), 87 Fed. Reg. 6625, 6625 (Feb. 3, 2022).

As amended by the temporary legislation, [§ 103\(i\)](#) states that subchapter V applies to a debtor, as defined in [§ 1182](#), who elects its application. Amended [§ 1182\(1\)](#) defines “debtor” with the same language that defines a “small business debtor” in [11 U.S.C.A. § 101\(51D\)](#), except for the amount of the debt limit.

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Under the temporary legislation, the definition of a debtor eligible for subchapter V in [§ 1182\(1\)](#) and the definition of a “small business debtor” in [§ 101\(51D\)](#) are the same, except for the debt limit. The definitions include additional provisions for determining eligibility. Debts owed to affiliates or insiders are excluded from the calculation of the debt limit. A debtor is not a small business debtor and is not eligible for subchapter V if: (1) the debtor's primary activity is the business of owning single asset real estate; (2) it is a member of a group of affiliated debtors in bankruptcy cases that have aggregate debts in excess of the debt limit; (3) the debtor is a corporation subject to the reporting requirements of the Securities Exchange Act of 1934; or (4) the debtor is an affiliate of such a reporting company. [11 U.S.C.A. § 101\(51D\)\(B\)\(iii\)](#) (definition of small business debtor); [11 U.S.C.A. § 1182\(1\)](#) (definition of subchapter V debtor). See generally Bonapfel, A Guide to the SBRA at 11-51, available at https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf. When the temporary legislation expires on June 24, 2024, only a “small business debtor” will be eligible for subchapter V. Thus, the debt limit for a small business debtor and a subchapter V debtor will be the same: \$3,024,725.

Under the temporary legislation, a debtor eligible for subchapter V who does not elect subchapter V is a “small business debtor” in a “small business case” if its aggregate debts do not exceed \$3,024,725. A non-electing debtor whose debts exceed that amount is in a traditional chapter 11 case.

[20](#) [11 U.S.C.A. § 1184](#). The debtor may be removed from possession for cause. [11 U.S.C.A. § 1185](#).

[21](#) [11 U.S.C.A. § 1183\(a\), \(b\)\(7\)](#).

[22](#) [11 U.S.C.A. § 1181\(b\)](#).

[23](#) [28 U.S.C.A. § 1930\(a\)\(6\)\(A\)](#).

[24](#) [11 U.S.C.A. § 1189\(b\)](#).

[25](#) [11 U.S.C.A. 1181\(b\)](#); [11 U.S.C.A. § 1125](#). In a traditional or small business chapter 11 case, [§ 1125](#) requires the filing of a separate disclosure statement in connection with the filing of a plan that provides “adequate information” for creditors to make an informed judgment about the plan. In a traditional case, the court must approve the disclosure statement prior to the solicitation of votes on the plan. [11 U.S.C.A. § 1125\(b\)](#). In a small business case, the court may determine that the plan itself contains adequate information and may conditionally approve a disclosure statement, with final approval occurring at the time of confirmation. [11 U.S.C.A. § 1125\(f\)](#).

The compilation of a disclosure statement may impose significant cost on a debtor in the form of attorney's fees and may provoke tactical or strategic objections that result in time-consuming litigation and more attorney's fees. The result of the process, however, has marginal—if any—value in the case of a smaller business. Creditors actively participating in the case likely have the information they need to evaluate the plan and do not need a disclosure statement to make their decisions. Creditors who are not active participants are likely to be unsecured; in many cases, all they need to know is whether the plan provides for them to receive more than liquidation. It is questionable whether participants who are not active in the case will even bother to read it.

[26](#) [11 U.S.C.A. § 1190\(1\)](#).

[27](#) [11 U.S.C.A. § 1188\(a\)](#).

[28](#) [11 U.S.C.A. § 1188\(c\)](#).

[29](#) [Section 1191\(a\)](#) provides for confirmation of a subchapter V plan if it meets all the requirements of [§ 1129\(a\)](#) except [§ 1129\(a\)\(15\)](#). [Section 1129\(a\)\(15\)](#) does not apply in a subchapter V case. [11 U.S.C.A. §§ 1181\(a\), 1191\(a\)](#). [Section 1129\(a\)\(15\)](#) imposes a projected disposable income requirement if the debtor is an individual upon the objection of an unsecured creditor if the plan does not provide for payment of the claim in full. Because [§ 1129\(a\)\(15\)](#) does not apply in a traditional or small business case of a

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corporation, the requirements for confirmation in a corporate case are the same in a subchapter V case under [§ 1191\(a\)](#) as in a traditional or small business case under [§ 1129\(a\)](#).

[30](#) Any chapter 11 plan must classify creditors, and the members of each impaired class are entitled to vote to accept or reject the plan. A plan must also deal with interests in the debtor, that is, the owners of its equity. Because smaller businesses are usually closely held. The discussion here for convenience and brevity does not deal with issues relating to interests.

A plan impairs a creditor unless (1) it does not alter the legal, equitable, and contractual rights of the creditor or (2) it provides for the cure of any defaults and reinstatement of the maturity of the claim, compensates the creditor for damages arising from any defaults, and otherwise does not alter the creditor's rights. [11 U.S.C.A. § 1124](#).

Acceptance requires acceptance by a majority of creditors voting on the plan that hold at least two-thirds of the amount of the claims held by the voting creditors. [11 U.S.C.A. § 1126\(c\)](#).

[31](#) [11 U.S.C.A. § 1129\(b\)\(1\)](#). In a traditional or small business case, [§ 1129\(b\)](#) permits cramdown confirmation if the plan meets all of the requirements of [§ 1129\(a\)](#), except the requirement in [§ 1129\(a\)\(8\)](#) that all impaired classes accept it. The confirmation requirements of [§ 1129\(a\)](#) include the requirement in [§ 1129\(a\)\(10\)](#) that, if any class of claims is impaired, at least one impaired class accept the plan.

[32](#) [11 U.S.C.A. § 506\(a\)](#). [Section 506\(a\) of the Bankruptcy Code](#) provides for allowance of a claim as secured to the extent of the value of the assets that secure the claim. The difference between the amount of the claim and the value of the encumbered property is allowable as an unsecured claim. Accordingly, a class of unsecured claims includes the deficiency claim of a secured lender if its debt exceeds the value of its collateral.

[33](#) [11 U.S.C.A. § 1191\(b\)](#). [Section 1191\(b\)](#) permits cramdown confirmation in accordance with the cramdown requirements if all of the requirements of [§ 1129\(a\)](#) are met except, among other things, the requirement of [§ 1129\(a\)\(10\)](#) that at least one class of impaired claims accept the plan. See generally Bonapfel, A Guide to the SBRA, *supra* note 12, at 121–61 (rev. ed. June 2022), available at https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf.

[34](#) [11 U.S.C.A. § 1191\(c\)\(2\)](#). See generally Bonapfel, A Guide to the SBRA, at 141–55 (rev. ed. June 2022), available at https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf.

[35](#) [11 U.S.C.A. § 1191\(c\)\(3\)](#). See generally Bonapfel, A Guide to the SBRA, at 155–61 (rev. ed. June 2022), available at https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf.

[36](#) See, e.g., [Bank of America Nat. Trust and Sav. Ass'n v. 203 North LaSalle Street Partnership](#), 526 U.S. 434, 444, 119 S. Ct. 1411, 143 L. Ed. 2d 607, 34 Bankr. Ct. Dec. (CRR) 329, 41 Collier Bankr. Cas. 2d (MB) 526, Bankr. L. Rep. (CCH) P 77924 (1999).

[37](#) [11 U.S.C.A. § 1129\(b\)\(2\)\(B\)](#).

[38](#) [11 U.S.C.A. § 1129\(b\)\(2\)\(B\)\(ii\)](#). The discussion here excludes consideration of the cramdown requirements with regard to secured claims, [11 U.S.C.A. § 1129\(b\)\(2\)\(A\)](#), and application of the absolute priority rule with regard to interests, [11 U.S.C.A. § 1129\(b\)\(2\)\(C\)](#). Subchapter V does not change the requirements for cramdown confirmation with regard to secured claims. [Section 1191\(c\)\(1\)](#) provides that the condition that a plan be fair and equitable in a subchapter V case with regard to a class of secured claims requires that it comply with the requirements of [§ 1129\(b\)\(2\)\(A\)](#) that govern cramdown with regard to a rejecting secured class in a traditional case. [11 U.S.C.A. § 1191\(c\)\(1\)](#). Moreover, the absolute priority rule does not apply to cramdown of a secured claim. A subchapter V case in most instances involves a closely held corporation, whose owners can be expected to accept the plan, so the absolute priority rule with regard to interests is not an issue.

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- 39 [11 U.S.C.A. § 1129\(b\)\(2\)\(B\)\(ii\).](#)
- 40 [11 U.S.C.A. § 1129\(b\)\(2\)\(B\)\(i\).](#)
- 41 See 7 COLLIER ON BANKRUPTCY ¶ 1129.03[4][c] (16th ed. 2023). As the treatise notes, the Supreme Court in three cases has declined to determine whether the new value exception still exists in chapter 11 cases. [Bank of America Nat. Trust and Sav. Ass'n v. 203 North LaSalle Street Partnership](#), 526 U.S. 434, 438, 119 S. Ct. 1411, 143 L. Ed. 2d 607, 34 Bankr. Ct. Dec. (CRR) 329, 41 Collier Bankr. Cas. 2d (MB) 526, Bankr. L. Rep. (CCH) P 77924 (1999); [U.S. Bancorp Mortg. Co. v. Bonner Mall Partnership](#), 513 U.S. 18, 20 n.1, 115 S. Ct. 386, 130 L. Ed. 2d 233, 26 Bankr. Ct. Dec. (CRR) 253, Bankr. L. Rep. (CCH) P 76170, 30 Fed. R. Serv. 3d 1 (1994) (In dismissing appeal for mootness due to settlement of an appeal from a Ninth Circuit ruling that the new value exception applies in Chapter 11 cases and declining to vacate the lower court's judgment, the Court expressly stated, "[w]e express no opinion on the existence of such an exception under the Bankruptcy Code."); [Norwest Bank Worthington v. Ahlers](#), 485 U.S. 197, 203 n.3, 108 S. Ct. 963, 99 L. Ed. 2d 169, 17 Bankr. Ct. Dec. (CRR) 201, 18 Collier Bankr. Cas. 2d (MB) 262, Bankr. L. Rep. (CCH) P 72186 (1988) (declining request of United States, as amicus curiae, to rule that codification of the absolute priority rule in Chapter 11 eliminated the new value exception because the individual debtors' promise to contribute labor, experience, and expertise to the reorganized debtor could not qualify as new value). Many lower courts have applied the new value exception. Others have questioned it without expressly rejecting it. A few have concluded that it is no longer available. For a detailed discussion of lower court decisions on the new value exception, see nn. 165–67 and accompanying text in 7 COLLIER ON BANKRUPTCY ¶ 1129.03[4][c] (16th ed. 2023).
- 42 E.g., [Matter of Woodbrook Associates](#), 19 F.3d 312, 319–20, 30 Collier Bankr. Cas. 2d (MB) 551, Bankr. L. Rep. (CCH) P 75780 (7th Cir. 1994); [In re Bonner Mall Partnership](#), 2 F.3d 899, 909, 24 Bankr. Ct. Dec. (CRR) 883, 29 Collier Bankr. Cas. 2d (MB) 668, Bankr. L. Rep. (CCH) P 75374 (9th Cir. 1993); [In re U.S. Truck Co., Inc.](#), 800 F.2d 581, 588, 14 Bankr. Ct. Dec. (CRR) 1327, 15 Collier Bankr. Cas. 2d (MB) 553, 123 L.R.R.M. (BNA) 2849, Bankr. L. Rep. (CCH) P 71460 (6th Cir. 1986); [In re Brotby](#), 303 B.R. 177, 195, 42 Bankr. Ct. Dec. (CRR) 91, 51 Collier Bankr. Cas. 2d (MB) 677 (B.A.P. 9th Cir. 2003); see 7 COLLIER ON BANKRUPTCY ¶ 1129.03[4][c][iv]; (16th ed. 2023); see also [NORTON BANKRUPTCY LAW AND PRACTICE 3D § 113:25](#).
- 43 E.g., [Woodbrook Assocs.](#), 19 F.3d at 320; [Bonner Mall P'ship](#), 2 F.3d at 908; [Matter of Snyder](#), 967 F.2d 1126, 1131, 23 Bankr. Ct. Dec. (CRR) 287, 27 Collier Bankr. Cas. 2d (MB) 285, Bankr. L. Rep. (CCH) P 74754 (7th Cir. 1992); [U.S. Truck Co.](#) 800 F.2d at 588; [Brotby](#), 303 B.R. at 195; see also 7 COLLIER ON BANKRUPTCY ¶ 1129.03[4][c][iv][D] (16th ed. 2023) (n. 251 and accompanying text); [NORTON BANKRUPTCY LAW AND PRACTICE 3D § 113:25](#).
- 44 [Bank of America Nat. Trust and Sav. Ass'n v. 203 North LaSalle Street Partnership](#), 526 U.S. 434, 119 S. Ct. 1411, 143 L. Ed. 2d 607, 34 Bankr. Ct. Dec. (CRR) 329, 41 Collier Bankr. Cas. 2d (MB) 526, Bankr. L. Rep. (CCH) P 77924 (1999).
- 45 [Bank of Am. Nat'l Trust and Sav. Ass'n v. 203 North LaSalle St. P'ship](#), 526 U.S. at 458; see also [NORTON BANKRUPTCY LAW AND PRACTICE 3D § 113:25](#).
- 46 See [In re Corinthian Communications, Inc.](#), 642 B.R. 224, 225 (Bankr. S.D. N.Y. 2022) (“It is often the debtor's owner who built the business—developing and maintaining relationships with employees, customers and vendors that give the debtor a chance at successfully reorganizing. Remove the owner's authority to manage the business as a debtor in possession, and the debtor is more likely to fail.”).
- 47 [11 U.S.C.A. § 1181\(b\).](#)
- 48 The cramdown requirements of [§ 1129\(b\)\(2\)\(A\)](#) applicable to a secured claim apply in a subchapter V case. [11 U.S.C.A. § 1181\(c\)\(1\).](#)

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49 [11 U.S.C.A. § 1191\(c\)\(2\)\(A\).](#)

50 [11 U.S.C.A. § 1191\(c\)\(2\)\(B\).](#)

51 [11 U.S.C.A. § 1225\(b\).](#)

52 [11 U.S.C.A. § 1191\(c\)\(3\).](#)

53 [11 U.S.C.A. § 1191\(c\)\(3\).](#)

54 Hon. Michelle Harner, Emily Lamasa, and Kimberly Goodwin, Subchapter V Cases By The Numbers, 40 AM. BANKR. INST. J., Oct. 2021, at 12, 59. Emily Lamasa is a career law clerk and Kimberly Goodwin is Judge Harner's paralegal.

55 Harner, Lamasa & Goodwin, [Subchapter V Cases by the Numbers](#), 40 AM. BANKR. INST. J., at 12, 59. The dataset included 438 randomly selected cases filed between February 19, 2020 and December 31, 2020, with data collection ending on June 30, 2021. The cases were randomly selected based on a list of 1,278 cases (excluding duplicate cases) filed during the period, representing approximately 36 percent of the cases filed. The data set included at least one case in each Circuit. "As of June 30, 2021, the court had confirmed a plan in 221 cases, the debtor had filed a plan that had not yet been confirmed in 105 cases, the debtor had not filed a plan in 30 cases, and the court had dismissed 82 cases." The debtor had not filed a plan at the time of dismissal in 55 of them. In the 30 cases with no plan, the court had converted 25 cases (24 to chapter 7, one to chapter 13) and extended the deadline for the filing of a plan in five. Consensual confirmation occurred in 130 cases, approximately 59 percent. When nonconsensual confirmation occurred in the other 91 cases, 40 had at least one class of impaired creditors voting against the plan and 51 had impaired classes that did not vote. The average time from filing of the case to confirmation was 184 days, and the median time was 168 days.

56 Chapter 11 Subchapter V Statistical Summary Through August 31, 2022, U.S. TRUSTEE PROGRAM, <https://www.justice.gov/ust/page/file/1499276/download> (last visited Feb. 25, 2023). The data includes only cases filed in United States Trustee Program districts, which thus excludes Alabama and North Carolina. For subchapter V cases through September 20, 2022, the report shows that confirmation occurred in 58 percent of them and that confirmation was consensual in approximately 70 percent. Conversion occurred in 25 percent of the cases, and 10 percent were dismissed. The remaining seven percent were pending without a confirmed plan. It reports the median months to confirmation as 6.5 and the median months to dismissal as 4.7.

57 Chapter 11 Subchapter V Statistical Summary Through August 31, 2022, U.S. TRUSTEE PROGRAM, <https://www.justice.gov/ust/page/file/1499276/download> (last visited Feb. 25, 2023).

58 See [In re Corinthian Communications, Inc.](#), 642 B.R. 224, 225 (Bankr. S.D.N.Y. 2022) ("[Subchapter V] has been a remarkably successful addition to Chapter 11 of the Bankruptcy Code.").

Judge Bonapfel has presented more than 25 continuing legal education programs on subchapter V since its enactment. Although some have expressed reservations or problems with subchapter V, most conclude that it is working as intended to expedite reorganization of smaller businesses that should be reorganized and to expedite dismissal or conversion of cases where reorganization is not feasible.

59 E.g., [Dewsnup v. Timm](#), 502 U.S. 410, 419, 112 S. Ct. 773, 116 L. Ed. 2d 903, 22 Bankr. Ct. Dec. (CRR) 750, 25 Collier Bankr. Cas. 2d (MB) 1297, Bankr. L. Rep. (CCH) P 74361A (1992) (quoting [In re John M. Russell, Inc.](#), 318 U.S. 515, 521, 63 S. Ct. 687, 87 L. Ed. 954 (1943)).

60 Bankruptcy Act of 1898, Pub. L. No. 55-541, 30 Stat. 544 (repealed 1978).

61 The most notable amendment was the Chandler Act of 1938, Pub. L. No. 75-696, 52 Stat. 840, which added the reorganization chapters. For a discussion of amendments to the Bankruptcy Act, see Charles

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- Jordan Tabb, [The History of the Bankruptcy Laws in the United States](#), 3 AM. BANKR. INST. L. REV. 5, 23–32 (1995).
- [62](#) Bankruptcy Reform Act of 1978, Pub. L. No. 55-541, [Pub. L. No. 95-598, 92 Stat. 2549](#).
- [63](#) Charles Jordan Tabb, [The History of the Bankruptcy Laws in the United States](#), 3 AM. BANKR. INST. L. REV. 5, 24 (1995).
- [64](#) Bankruptcy Act of 1898, Pub. L. No. 55-541 § 17, 30 Stat. 544, 550–51 (repealed 1978).
- [65](#) Charles Jordan Tabb, [The History of the Bankruptcy Laws in the United States](#), 3 AM. BANKR. INST. L. REV. 5, 27 (1995).
- [66](#) Bankruptcy Act of 1898, Pub. L. No. 55-541, sec. 4b, 30 Stat. 544, 547 (repealed 1978) (Corporation is subject to involuntary bankruptcy if it is “engaged principally in manufacturing, trading, printing, publishing, or mercantile pursuits” and owes debts of \$1,000 or more).
- [67](#) Bankruptcy Act of 1898, Pub. L. No. 55-541, sec. 4a, 30 Stat. 544, 547 (repealed 1978).
- [68](#) Act of June 25, 1910, sec. 3, 36 Stat. 838, 839 (extending eligibility for voluntary bankruptcy to “[a]ny person except a municipal, railroad, insurance, or banking corporation”).
- [69](#) See Charles Jordan Tabb, [The History of the Bankruptcy Laws in the United States](#), 3 AM. BANKR. INST. L. REV. 5, 28–30 (1995).
- [70](#) Chandler Act of 1938, Pub. L. No. 75-696, 52 Stat. 840. The Chandler Act did not amend chapter IX of the Bankruptcy Act, dealing with municipal reorganizations, which was enacted in 1937, Act of Aug. 16, 1937, Pub. L. No. 75-302, 50 Stat. 653, or section 77, which governed railroad reorganizations. The Bankruptcy Reform Act of 1978 provided for municipal reorganizations in chapter 9 and railroad reorganizations in subchapter IV of chapter 11. See, e.g., NORTON BANKRUPTCY LAW AND PRACTICE 3D § 90.1 (municipal reorganizations); § 117:2 (railroad reorganizations).
- [71](#) Chandler Act of 1938, Pub. L. No. 75-696, 52 Stat. 840, 883–905 (chapter X); Chandler Act of 1938, Pub. L. No. 75-696, 52 Stat. 840, 905–16 (chapter XI); Chandler Act of 1938, Pub. L. No. 75-696, 52 Stat. 840, 916–30 (chapter XII); Chandler Act of 1938, Pub. L. No. 75-696, 52 Stat. 840, 930–38 (chapter XIII).
- [72](#) See Charles Jordan Tabb, [The History of the Bankruptcy Laws in the United States](#), 3 AM. BANKR. INST. L. REV. 5, 28 (1995).
- [73](#) Chandler Act of 1938, Pub. L. No. 75-696, sec. 101-276, 52 Stat. 840, 883–905 (repealed 1978).
- [74](#) Chandler Act of 1938, Pub. L. No. 75-696, sec. 106(5), 52 Stat. 840, 883 (repealed 1978).
- [75](#) Chandler Act of 1938, Pub. L. No. 75-696, sec. 228(1), 52 Stat. 840, 883–905 (repealed 1978).
- [76](#) Chandler Act of 1938, Pub. L. No. 75-696, sec. 271, 52 Stat. 840, 904 (repealed 1978).
- [77](#) Ralph Brubaker, [Taking Exception to the New Corporate Discharge Exceptions](#), 13 AM. BANKR. INST. L. REV. 757, 763 (2005).
- [78](#) Chandler Act of 1938, Pub. L. No. 75-696, sec. 301-99, 52 Stat. 840, 906 (repealed 1978).
- [79](#) Chandler Act of 1938, Pub. L. No. 75-696, sec. 306(1), 52 Stat. 840, 906 (repealed 1978) (defining “arrangement”).
- [80](#) Chandler Act of 1938, Pub. L. No. 75-696, sec. 371, 52 Stat. 840, 912 (repealed 1978).

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- 81 Chandler Act of 1938, Pub. L. No. 75-696, sec. 366(4), 52 Stat. 840, 912 (repealed 1978).
- 82 Chandler Act of 1938, Pub. L. No. 75-696, secs. 401 to 526, 52 Stat. 840, 916–30 (repealed 1978).
- 83 Chandler Act of 1938, Pub. L. No. 75-696, sec. 406(1), 52 Stat. 840, 916 (repealed 1978).
- 84 Chandler Act of 1938, Pub. L. No. 75-696, sec. 461(3), 52 Stat. 840, 922 (repealed 1978).
- 85 Chandler Act of 1938, Pub. L. No. 75-696, sec. 406(6), 52 Stat. 840, 917 (repealed 1978) (defining debtor).
- 86 Chandler Act of 1938, Pub. L. No. 75-696, sec. 476, 52 Stat. 840, 924 (repealed 1978).
- 87 Chandler Act of 1938, Pub. L. No. 75-696, sec. 472(3), 52 Stat. 840, 923 (repealed 1978).
- 88 Chandler Act of 1938, Pub. L. No. 75-696, secs. 601 to 686, 52 Stat. 840, 930–38 (repealed 1978).
- 89 Chandler Act of 1938, Pub. L. No. 75-696, secs. 606(3), 606(8), 621 to 22, 52 Stat. 840, 930–31 (repealed 1978).
- 90 Chandler Act of 1938, Pub. L. No. 75-696, sec. 646, 52 Stat. 840, 934 (repealed 1978).
- 91 Chandler Act of 1938, Pub. L. No. 75-696, sec. 660, 52 Stat. 840, 935–36 (repealed 1978).
- 92 Chandler Act of 1938, Pub. L. No. 75-696, sec. 661, 52 Stat. 840, 936 (repealed 1978).
- 93 Chandler Act of 1938, Pub. L. No. 75-696, sec. 656(a)(3), 52 Stat. 840, 935 (repealed 1978).
- 94 Bankruptcy Reform Act of 1978, [Pub. L. No. 95-598, 92 Stat. 2549](#).
- 95 The Bankruptcy Reform Act of 1978 also replaced chapter IX with chapter 9.
- 96 [11 U.S.C.A. § 727\(a\)](#).
- 97 [11 U.S.C.A. § 523\(a\)](#). Later legislation expanded the types of debts excepted from discharge under [§ 523\(a\)](#). See *supra* note 1.
- 98 Brubaker, [Taking Exception, 13 AM. BANKR. INST. L. REV. at 764](#).
- 99 Chandler Act of 1938, Pub. L. No. 75-696, sec. 156, 52 Stat. 840, 888 (repealed 1978).
- 100 Brubaker, [Taking Exception, 13 AM. BANKR. INST. L. REV. at 764](#).
- 101 [11 U.S.C.A. § 1141\(d\)\(1\)\(A\)](#). Later legislation added [§ 1141\(d\)\(6\)](#) to except certain debts from the discharge of a corporation. See *infra* text accompanying notes 111–14.
- 102 [11 U.S.C.A. § 1141\(d\)\(3\)](#). Specifically, [§ 1141\(d\)\(3\)](#) provides for denial of the discharge when the conditions stated in the text exist and the debtor would be denied a discharge under [11 U.S.C.A. § 727\(a\)](#) if the case were in chapter 7. A corporation cannot receive a chapter 7 discharge. [11 U.S.C.A. § 727\(a\)\(1\)](#).
- 103 [11 U.S.C.A. § 523\(a\)](#) (emphasis added).
- 104 [11 U.S.C.A. § 103\(a\)](#).
- 105 [11 U.S.C.A. § 1141\(d\)\(2\)](#).

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- [106](#) Brubaker, [Taking Exception, 13 AM. BANKR. INST. L. REV. at 764, 765–66 & nn. 46–49](#) (emphasis in original; internal footnotes 46–49 included and quoted *infra* notes 107–110).
- [107](#) “Congress cited the differing scope of the corporate discharge as among the most ‘essential differences between Chapters X and XI’ requiring reconciliation in the consolidated, unitary chapter 11 reorganization process. 124 CONG. REC. 34,003 (1978) (statement of Sen. DeConcini); 124 CONG. REC. 32,404 (1978) (statement of Rep. Edwards). The floor statements of the foregoing floor managers of the 1978 legislation are ‘persuasive evidence of congressional intent,’ generally regarded as the equivalent of a conference report. [Begier v. I.R.S., 1990-2 C.B. 265, 496 U.S. 53, 64 n.5, 110 S. Ct. 2258, 110 L. Ed. 2d 46, 20 Bankr. Ct. Dec. \(CRR\) 940, 22 Collier Bankr. Cas. 2d \(MB\) 1080, Bankr. L. Rep. \(CCH\) P 73403, 90-1 U.S. Tax Cas. \(CCH\) P 50294, 65 A.F.T.R.2d 90-1095 \(1990\).](#)” Brubaker, [Taking Exception, 13 AM. BANKR. INST. L. REV. 765 n. 46.](#)
- [108](#) “The 1973 Commission originally proposed a corporate discharge upon confirmation of a plan of reorganization comparable to that available under chapter X—a comprehensive discharge of all debts, excepting only certain priority tax debts. See 1973 Commission Report, *supra* note 26, pt. 11, § 4-506(a), at 136; Commission Report, § 7-311(c) & note 3, at 255; § 7-315(e) & note 6, at 260. Subsequent bills introduced simultaneously—reflecting the Commission’s proposals in one bill and the competing proposals of the National Conference of Bankruptcy Judges (NCBJ) in another—both adopted this same approach with respect to corporate discharge in reorganization. See S. 236, 94th Cong. §§ 4-506(a), 7-311(c), 7-315(e) (1975) (Commission bill); H.R. 31, 94th Cong. §§ 4-506(a), 7-311(c), 7-315(e) (1975) (Commission bill); S. 235, 94th Cong. §§ 4-506(a), 4-719(e), 7-309(c), 8-307(b) (1975) (NCBJ bill); H.R. 32, 94th Cong. §§ 4-506(a), 4-719(e), 7-309(c), 8-307(b) (1975); Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary, 94th Cong. (1975–1976) (H.R. 31/32 Hearings), app. 1, at 156, 263, 269–70, 284 (displaying side-by-side comparison of provisions of Commission and NCBJ bills). The legislation that subsequently progressed through both the House and Senate, though differing in the precise details, likewise provided an exception to the corporate discharge in chapter 11 only for certain priority taxes. See Bankruptcy Reform Act of 1978: Hearings on S. 2266 and H.R. 8200 Before the Subcomm. on Improvements in Judicial Machinery of the S. Comm. on the Judiciary, 95th Cong. 3, 234–35, 244 (1978) (comparing sections 1141(d)(1)-(2) and 1146(e) of H.R. 8200 as reported by H. Comm. on Judiciary, Sept. 8, 1977, and S. 2266 as introduced in Senate, Oct. 31, 1977); [H.R. REP. NO. 95-595, at 418, 421–22](#) (1977); S. 2266, 95th Cong. [§§ 1141\(d\)\(1\)\(A\)–\(B\), 1146\(e\)](#) (as reported by Subcomm. on Improvements in Judicial Machinery of S. Comm. on the Judiciary, May 17, 1978); [S. REP. NO. 95-989, at 129–30, 133](#) (1978). The Senate Finance Committee proposed an expansion of the discharge exception to also encompass non-priority tax debts involving fraud in certain situations. See S. 2266, 95th Cong., [§§ 1141\(d\)\(2\), 1146\(d\)](#) (as reported by S. Comm. on Finance, Aug. 10, 1978); S. REP. NO. 95-1106, at 25, 28 (1978). In the subsequent resolution of differences (without a formal conference) as between bills passed by the House and Senate, not only was the expansion proposed by the Senate Finance Committee rejected, the limited corporate discharge exception for priority tax debts (that had been a feature of chapter X, chapter XI, the Commission proposal, and all of the bills in the 94th and 95th Congresses) was entirely eliminated. See 124 CONG. REC. 34,008, 34,017 (statement of Sen. DeConcini); 124 CONG. REC. 32,408, 32,418 (statement of Rep. Edwards).” Brubaker, [Taking Exception, 13 AM. BANKR. INST. L. REV. at 765 n. 47.](#)
- [109](#) “[S]uccessful rehabilitation under chapter XI is often impossible for a number of reasons,’ including the fact that ‘a corporation in chapter XI may not be able to get a discharge in respect of certain kinds of claims including fraud claims, even in cases where the debtor is being operated under new management.’ 124 CONG. REC. 34, 004–05 (statement of Sen. DeConcini); 124 CONG. REC. 32, 405 (statement of Rep. Edwards). See H.R. 31/32 Hearings, *supra* note 108, pt. 3, at 1891 (statement of Harvey R. Miller, William J. Rochelle, Jr. & J. Ronald Trost, National Bankruptcy Conference) (‘One change from existing law which is strongly endorsed by the NBC is the provisions of H.R. 31 and H.R. 32 which provide that all claims ... are discharged upon confirmation of the plan ... whether or not the creditor’s claim would otherwise be nondischargeable in straight bankruptcy.’). Even those who favored retention of a separate arrangement process modeled on chapter XI, nonetheless, favored elimination therefrom

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- of the corporate discharge exceptions. See S. 235, 94th Cong. § 8-307(b) (1975) (NCBJ bill); H.R. 32, 94th Cong. § 8-307(b) (1975) (NCBJ bill); The Bankruptcy Reform Act: Hearings on S. 235 and S. 236 Before the Subcomm. on Improvements in the Judicial Machinery of the S. Comm. on the Judiciary, 94th Cong., pt. 11, at 402 (1975) (statement of Benjamin Weintraub, Esq. and Michael J. Crammes, Esq.) (Recommendation 6(d)).” Brubaker, [Taking Exception, 13 AM. BANKR. INST. L. REV. at 765 – 66 n. 49.](#)
- [110](#) 124 CONG. REC. 34,008 (1978) (statement of Sen. DeConcini); 124 CONG. REC. 32,408 (1978) (statement of Rep. Edwards). Brubaker, [Taking Exception, 13 AM. BANKR. INST. L. REV. at 766 n. 49.](#)
- [111](#) Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, [Pub. L. No. 109-8](#), sec. 708, 119 Stat. 23, 126 (2005).
- [112](#) 31 U.S.C.A. ch. 37, subch. III. See generally Roger S. Goldman et al., [Discharging False Claims Liability in Bankruptcy, Section 1141\(d\)\(6\)\(A\) of the Bankruptcy Code: An Incentive to Settle FCA Cases?](#), 23 No. 1 Health Law. 40 (Oct. 2010).
- [113](#) [11 U.S.C.A. § 1141\(d\)\(6\)\(B\).](#)
- [114](#) The excepted debts under [subparagraph \(A\) of § 1141\(d\)\(6\)\(A\)](#) for debts owed to a domestic governmental by definition are debts within the meaning of [§ 523\(a\)\(2\)](#), which excepts debts arising from false pretenses, a false representation, actual fraud, or use of a materially false financial statement. The debts excepted under subparagraph (A) for liability under the False Claims Act or a similar state statute similarly involve such conduct. The excepted debts for taxes under [§ 1141\(d\)\(6\)\(B\)](#) are the same as those described in [§ 523\(a\)\(1\)\(C\)](#).
- [115](#) Bankruptcy Reform Act of 1978, [Pub. L. No. 95-598](#), sec. 524, 92 Stat. 2549, 2592 (1978).
- [116](#) [11 U.S.C.A. § 109\(e\)](#) provides that only an individual with regular income, or such an individual and such individual's spouse in a joint case, with debts within prescribed debt limits, may be a debtor under chapter 13.
- [117](#) [11 U.S.C.A. § 109\(f\)](#) makes a “family farmer or family fisherman” with regular income eligible for chapter 12. The definitions of “family farmer,” [11 U.S.C.A. § 101\(18\)\(B\)](#), and “family fisherman,” [11 U.S.C.A. § 101\(19\)\(B\)](#), include a corporation or partnership with specified requirements.
- [118](#) [11 U.S.C.A. § 1328\(a\)](#). See DRAKE, BONAPFEL AND GOODMAN, CHAPTER 13 PRACTICE AND PROCEDURE §§ 21:1, 21:7, 21:21.
- [119](#) [11 U.S.C.A. § 1328\(b\)](#). See DRAKE, BONAPFEL AND GOODMAN, CHAPTER 13 PRACTICE AND PROCEDURE § 21:8.
- [120](#) See DRAKE, BONAPFEL AND GOODMAN, CHAPTER 13 PRACTICE AND PROCEDURE § 21:13.
- [121](#) See DRAKE, BONAPFEL AND GOODMAN, CHAPTER 13 PRACTICE AND PROCEDURE § 21:13.
- [122](#) [11 U.S.C.A. § 1328\(c\)\(2\).](#)
- [123](#) [11 U.S.C.A. § 1328\(a\)\(1\), 1328\(c\)\(2\).](#)
- [124](#) [11 U.S.C.A. § 1322\(b\)\(5\)](#); see also DRAKE, BONAPFEL AND GOODMAN, CHAPTER 13 PRACTICE AND PROCEDURE § 21:14.
- [125](#) See DRAKE, BONAPFEL AND GOODMAN, CHAPTER 13 PRACTICE AND PROCEDURE § 5:25.

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- [126](#) Bankruptcy Judges, United States Trustees, and Family Farmer Act of 1986, [Pub. L. No. 99-554](#), sec. 255, 100 Stat. 3088, 3105 (1986). After several extensions, BAPCPA made chapter 12 a permanent part of the Bankruptcy Code. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, [Pub. L. No. 109-8](#), sec. 1001, 119 Stat. 23, 185 (2005).
- [127](#) Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, [Pub. L. No. 109-8](#), secs. 1004, 1007, 119 Stat. 23, 186–87 (2005).
- [128](#) The other amendments increased the debt limit, provided that a claim owed to a governmental unit arising from the sale, transfer, exchange, or other disposition of any farm asset entitled to priority under [11 U.S.C.A. § 507](#) (e.g., a tax resulting from a gain on such a transaction) could be treated as an unsecured claim, modified the eligibility requirement relating to the amount of the debtor's income from farming, and prohibited the retroactive assessment of disposable income. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, [Pub. L. No. 109-8](#), secs. 1002, 1003, 1005, 1006, 119 Stat. 23, 186–87 (2005).
- [129](#) See supra note 117.
- [130](#) See generally Small, [Chapter 12—The Family Farmer Bankruptcy Act of 1986](#), 1987 ANN. SURV. OF BANKR. LAW 1, at part I(A)(8).
- [131](#) See H.R. REP. NO. 99-178, at 4–8 (1985).
- [132](#) See Farm Bankruptcy: Hearings Before the Subcomm. on Administrative Practice and Procedure, and Courts of the Comm. on the Judiciary, 99th Cong. 60–61 (1986) (statement of Richard T. Stageman, Bankruptcy Judge, Southern District of Iowa); and at 172 (statement of A. Thomas Small, Bankruptcy Judge, Eastern District of North Carolina); see also Small, [Chapter 12—The Family Farmer Bankruptcy Act of 1986](#), 1987 ANN. SURV. OF BANKR. LAW 1, at part I(A)(8).
- [133](#) Small, [Chapter 12—The Family Farmer Bankruptcy Act of 1986](#), 1987 ANN. SURV. OF BANKR. LAW 1, at part I(A)(8).
- [134](#) H.R. REP. NO. 958 (1986) (Conf. Rep.).
- [135](#) [11 U.S.C.A. § 1228\(a\), \(b\)](#).
- [136](#) See infra notes 150 and 151.
- [137](#) [11 U.S.C.A. § 1228\(a\)\(2\)](#) (completion discharge); [11 U.S.C.A. § 1228\(c\)](#) (hardship discharge).

The one type of debt that is excepted under [§ 523\(a\)\(1\)\(A\) or \(B\)](#), but not from a chapter 12 discharge, is a tax entitled to priority under [11 U.S.C.A. § 507](#) arising from the sale, transfer, exchange, or other disposition of any farm asset (e.g., a tax resulting from a gain on such a transaction). An amendment to chapter 12 in 2017 added [11 U.S.C.A. § 1232](#) to chapter 12 to permit treatment of such a claim as an unsecured claim. Additional Supplemental Appropriations for Disaster Relief Requirements Act of 2017, [Pub. L. No. 115-72](#), sec. 1005(b)(1)(B), 131 Stat. 1224, 1233. [Section 1232\(c\)](#) provides that such a claim shall not be treated as a claim of a kind specified in [§ 523\(a\)\(1\)\(A\) or \(B\)](#). The amendment also amended [§§ 1228\(a\)\(2\)](#) and [1228\(c\)\(2\)](#) to provide for the exception of [§ 523\(a\)](#) debts except as provided in [§ 1232\(c\)](#).

[Sections 1228\(a\)\(2\)](#) and [1228\(c\)\(2\)](#) both refer to debts “of a kind specified” in [§ 523\(a\)](#), whereas [§ 1192\(2\)](#) refers to a debt “of the kind specified” in [§ 523\(a\)](#). As originally enacted, however, [§ 1228\(a\)\(2\)](#) excepted debts of the kind specified in [§ 523\(a\)](#), but [§ 1228\(c\)\(2\)](#) excepted debts of a kind specified in [§ 523\(a\)](#). Chapter 13 similarly used “the” in [§ 1328\(a\)\(2\)](#) and “a” in [§ 1328\(c\)\(2\)](#), and still does.

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In connection with the amendment in 2017 to add [§ 1232](#), a conforming amendment changed *the* to *a* in [§ 1228\(a\)\(2\)](#). Additional Supplemental Appropriations for Disaster Relief Requirements Act of 2017, [Pub. L. 115-72](#), § 1005(b)(1)(B)(i)(II), 131 Stat. 1224, 1234.

[138](#) [11 U.S.C.A. § 1228\(a\)\(1\)](#) (completion discharge); [11 U.S.C.A. § 1228\(c\)\(1\)](#) (hardship discharge). The chapter 12 provisions differ from those in chapter 13 in one respect. The chapter 13 discharges except debts “provided for” under [11 U.S.C.A. § 1322\(b\)\(5\)](#). The chapter 12 discharge provisions except debts “provided for” under [11 U.S.C.A. § 1222\(b\)\(5\)](#) (identical to [§ 1322\(b\)\(5\)](#) and [11 U.S.C.A. § 1222\(b\)\(9\)](#)).

[Section 1322\(b\)\(5\)](#) permits a chapter 13 plan to provide for the cure of defaults and maintenance of postpetition installment payments for a long-term debt (typically a real estate mortgage) on which the last payment is due after the final payment under the plan is due. Chapter 12 has the identical provision in [§ 1222\(b\)\(5\)](#). All of the chapter 12 and 13 discharges except claims provided for under the applicable section from discharge.

In chapter 12 cases, [§ 1222\(b\)\(9\)](#) permits payment of allowed secured claims “consistent with” [11 U.S.C.A. § 1225\(a\)](#), but over a period of time longer than the term of the plan. [Section 1225\(a\)](#) is the chapter 12 analog of [11 U.S.C.A. § 1325\(a\)\(5\)](#) in chapter 13 cases. Both permit payment of an allowed secured claim with payments having a value of the allowed amount of the secured claim. See DRAKE, BONAPFEL AND GOODMAN, CHAPTER 13 PRACTICE AND PROCEDURE § 5:10, 5:14. In a chapter 13 case, however, payments under this type of treatment must be completed within the plan term. DRAKE, BONAPFEL AND GOODMAN, CHAPTER 13 PRACTICE AND PROCEDURE §§ 5:10, 5:13. The chapter 12 discharge provisions differ from the chapter 13 discharge provisions because they also except claims provided for under [§ 1222\(b\)\(9\)](#) from discharge.

[139](#) Bankruptcy Judges, United States Trustees, and Family Farmer Act of 1986, [Pub. L. No. 99-554](#), sec. 257(n), 100 Stat. 3088, 3115.

[140](#) [11 U.S.C.A. § 523\(a\)](#) (emphasis added).

[141](#) Small, [Chapter 12—The Family Farmer Bankruptcy Act of 1986](#), 1987 ANN. SURV. OF BANKR. LAW [1](#), at part XV(a)(2).

[142](#) Senator Grassley put the section-by-section analysis of Senate Bill 1923 into the record as part of his remarks in support of the bill. 132 CONG. REC. 9711, 9898 (1986) (statement of Sen. Chuck Grassley). Senate Bill 1923 eventually made its way into the legislation that the Senate passed to replace House Bill 2211. See *supra* text accompanying notes 130–133. The discharge provision in Senate Bill 1923 was in § 1219, which became § 1228 in the enacted legislation. The discussion of the discharge provision is at 132 CONG. REC. 9711, 9898 (1986).

[143](#) Report of the House Judiciary Committee to accompany H.R. 2211, H.R. REP. NO. 99-178 (1985).

[144](#) H.R. REP. NO. 99-647 (1986) (Conf. Rep.).

[145](#) 131 CONG. REC. H4768–75 (1985) (statements of Reps. Michael Synar, Carlos Moorhead, James Jones, Richard Gephardt, Thomas Kindness, Eligio de la Garza, Hamilton Fish, Jr, Steve Gunderson, Daniel Glickman, Patricia Schroeder, John Williams, and William Alexander); 132 CONG. REC. H8986–9002 (1986) (statements by Reps. William Edwards, Hamilton Fish, Jr, Carlos Moorhead, Henry Hyde, Harold Daub, William Dannemeyer).

[146](#) 132 CONG. REC. S3528–29 (1986) (statements of Sens. Charles Grassley, Dennis DeConcini, Edward Zorinsky, and Alfonse D'Amato); 132 Cong. Rec. S5555–58 (1986) (statement of Sen. Charles Grassley); 132 CONG. REC. S5613–19 (1986) (statements of Sens. Strom Thurmond, Mitch McConnell, William

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Bradley, William Gramm); 132 CONG. REC. S15075–94 (1986) (statements of Sens. Charles Grassley, Jeremiah Denton, Dennis DeConcini, Orrin Hatch, Strom Thurmond, Lawton Chiles).

[147](#) Small, [Chapter 12—The Family Farmer Bankruptcy Act of 1986](#), 1987 ANN. SURV. OF BANKR. LAW [1](#), at part XV(A)(2).

[148](#) Small, [Chapter 12—The Family Farmer Bankruptcy Act of 1986](#), 1987 ANN. SURV. OF BANKR. LAW [1](#), at part XV(A)(2).

[149](#) [In re Breezy Ridge Farms, Inc.](#), 2009 WL 1514671, at *4 (Bankr. M.D. Ga. 2009); [In re JRB Consol., Inc.](#), 188 B.R. 373, 374 (Bankr. W.D. Tex. 1995).

[150](#) Specifically, [§ 1192\(1\)](#) does not discharge debts on which the last payment is due “after the first 3 years of the plan, or such other time not to exceed 5 years fixed by the court.” [11 U.S.C.A. § 1192\(1\)](#). Any longer period fixed by the court will presumably be the same period that the court fixes for the commitment of projected disposable income in connection with cramdown confirmation under [11 U.S.C.A. § 1191\(c\)\(2\)](#).

The language in [§ 1192\(1\)](#) differs from the language of [11 U.S.C.A. §§ 1228\(a\)\(1\)](#) (completion discharge) and [1228\(c\)\(1\)](#) (hardship discharge) but has the same purpose and effect. See *supra* note 138.

[151](#) There is one immaterial difference. In [chapter 12, § 1228\(a\)\(2\)](#) and [1228\(c\)\(2\)](#) except “any debt ... of a kind specified in [section 523\(a\)](#).” (emphasis added). See *supra* note 137. Under a cramdown plan in subchapter V, [§ 1192\(2\)](#) excepts “any debt ... of the kind specified in [section 523\(a\)](#).” (emphasis added).

[152](#) Small Business Reorganization Act (SBRA) of 2019, sec. 4(a)(8), 133 Stat. 1079 (codified in [11 U.S.C.A. § 523\(a\)](#)).

[153](#) H.R. REP. NO. 116-171 (2019), as reprinted in 2019 U.S.C.C.A.N. 366. The court in *In re Progressive Solutions* recites the progress of the SBRA through the House and Senate and notes that the only legislative history appears to be the Report and an unofficial transcript of a subcommittee hearing. [In re Progressive Solutions, Inc.](#), 615 B.R. 894, 895–98 (Bankr. C.D. Cal. 2020); Unofficial Transcript of Oversight of Bankruptcy Law and Legislative Proposals Before the Subcommittee on Antitrust, Commercial, & Administrative Law of the House Committee on the Judiciary, 116th Cong. 27 (2019). The opinion notes other public statements made by several Senators, but they do not discuss discharge or exceptions. *Supra* note 11 and *infra* notes 154 and 249 reference some of the testimony.

[154](#) H.R. REP. NO. 116-171, at 8 (2019), as reprinted in 2019 U.S.C.C.A.N. 366, 374.

[155](#) Retired Bankruptcy Judge Small submitted testimony in support of the legislation. His explanation of the [§ 1192](#) discharge similarly made no reference to the [§ 523\(a\)](#) exceptions as applying to the discharges of non-individuals. Hearing on Oversight of Bankruptcy Law & Legislative Proposals Before the Subcomm. on Antitrust, Com. & Admin. Law of the H. Comm. on the Judiciary, 116th Cong. 118 (2019) (Testimony of A. Thomas Small, Retired Bankruptcy Judge, on behalf of the National Bankruptcy Conference).

[156](#) Compare, e.g., [5 NORTON BANKRUPTCY LAW AND PRACTICE § 107:19 \(3d. ed. 2023\)](#); James B. Bailey and Andrew J. Shaver, The Small Business Reorganization Act of 2019, NORTON BANKR. L. ADVISER, Oct. 2019, Part IX (exceptions are applicable to discharge of subchapter V corporation after cramdown confirmation) with Robert J. Keach and Adam R. Prescott, Balancing Act: How the Small Business Reorganization Act Facilitates Successful Reorganizations (And How Judicial “Re-balancing” Could Affect That Success), 31 No. 6 Norton J. Bankr. L. & Prac. Art. 1 at (D)(i) (Jan. 2023) (exceptions are not applicable to discharge of corporation after cramdown corporation); Richard P. Cook, Discharges in Subchapter V: What Has Changed? What Remains the Same? Are Elephants Hiding in Mouseholes?, 41 AM. BANKR. INST. J., June 2022, at 24 (exceptions should not be applicable to discharge of subchapter V corporation after cramdown corporation). See generally Paul W. Bonapfel, [A Guide to the](#)

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- [Small Business Reorganization Act of 2019, 93 AM. BANKR. L. J. 571, 621–24 \(2019\)](#) (discussing issue shortly after enactment of subchapter V).
- 157 Small Business Reorganization Act (SBRA) of 2019, § 4(a)(8), [Pub. L. No. 116-54, 133 Stat. 1079](#) (emphasis added).
- 158 [In re Off-Spec Solutions, LLC, 651 B.R. 862 \(B.A.P. 9th Cir. 2023\)](#), notice of appeal filed, No. 23-60034 (9th Cir., July 20, 2023); [In re 2 Monkey Trading, LLC, 650 B.R. 521, 72 Bankr. Ct. Dec. \(CRR\) 132 \(Bankr. M.D. Fla. 2023\)](#), notice of appeal filed, No. 23-12342 (11th Cir., July 19, 2023); [In re Hall, 651 B.R. 62 \(Bankr. M.D. Fla. 2023\)](#), [In re GFS Industries, LLC, 647 B.R. 337 \(Bankr. W.D. Tex. 2022\)](#), notice of appeal filed, No. 23-60034 (5th Cir., April 7, 2023); [In re Lapeer Aviation, Inc., 71 Bankr. Ct. Dec. \(CRR\) 112, 2022 WL 1110072, at *2 \(Bankr. E.D. Mich. 2022\)](#); [In re Rtech Fabrications, LLC, 635 B.R. 559, 564 \(Bankr. D. Idaho 2021\)](#); [In re Cleary Packaging, LLC, 630 B.R. 466, 70 Bankr. Ct. Dec. \(CRR\) 112 \(Bankr. D. Md. 2021\)](#), rev'd and remanded, [36 F.4th 509 \(4th Cir. 2022\)](#); [In re Satellite Restaurants Inc. Crabcake Factory USA, 626 B.R. 871, 876, 70 Bankr. Ct. Dec. \(CRR\) 12 \(Bankr. D. Md. 2021\)](#). One bankruptcy court ruled that a judgment for patent infringement against a corporation in a subchapter V case was excepted from discharge under [§ 523\(a\)\(6\)](#) as a willful and malicious injury without addressing whether [§ 523\(a\)](#) exceptions apply to the discharge of a corporation or citing the applicable subchapter V discharge provision, [11 U.S.C.A. § 1192\(2\)](#). [In re Better Than Logs, Inc., 631 B.R. 670, 688–89 \(Bankr. D. Mont. 2021\)](#).
- 159 [In re Cleary Packaging, LLC, 36 F.4th 509, 512 \(4th Cir. 2022\)](#).
- 160 [Cleary Packaging, LLC, 36 F.4th at 515](#).
- 161 [Cleary Packaging, LLC, 36 F.4th at 515](#) (emphasis in original).
- 162 [In re Satellite Restaurants Inc. Crabcake Factory USA, 626 B.R. 871, 70 Bankr. Ct. Dec. \(CRR\) 12 \(Bankr. D. Md. 2021\)](#).
- 163 [In re Cleary Packaging LLC, 630 B.R. 466, 466, 70 Bankr. Ct. Dec. \(CRR\) 112 \(Bankr. D. Md. 2021\)](#), rev'd and remanded, [36 F.4th 509 \(4th Cir. 2022\)](#).
- 164 [In re Off-Spec Solutions, LLC, 651 B.R. 862 \(B.A.P. 9th Cir. 2023\)](#), notice of appeal filed, No. 23-60034 (9th Cir., July 20, 2023); [In re 2 Monkey Trading, LLC, 650 B.R. 521, 72 Bankr. Ct. Dec. \(CRR\) 132 \(Bankr. M.D. Fla. 2023\)](#), notice of appeal filed, No. 23-12342 (11th Cir., July 19, 2023); [In re Hall, 651 B.R. 62 \(Bankr. M.D. Fla. 2023\)](#), [In re GFS Industries, LLC, 647 B.R. 337 \(Bankr. W.D. Tex. 2022\)](#), notice of appeal filed, No. 23-60034 (5th Cir., April 7, 2023); [In re Lapeer Aviation, Inc., 71 Bankr. Ct. Dec. \(CRR\) 112, 2022 WL 1110072 \(Bankr. E.D. Mich. 2022\)](#); [In re Rtech Fabrications, LLC, 635 B.R. 559, 563 \(Bankr. D. Idaho 2021\)](#). Two bankruptcy courts in unreported decisions ruled that the exceptions apply, and one court excepted a debt from discharge without discussing the issue. See *supra* note 6.
- 165 E.g., [Off-Spec Solutions, LLC, 651 B.R. at 866](#), notice of appeal filed, No. 23-60034 (9th Cir. July 20, 2023) (citing [U.S. v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241, 109 S. Ct. 1026, 103 L. Ed. 2d 290, 18 Bankr. Ct. Dec. \(CRR\) 1150, Bankr. L. Rep. \(CCH\) P 72575, 89-1 U.S. Tax Cas. \(CCH\) P 9179, 63 A.F.T.R.2d 89-652 \(1989\)](#) and [Lamie v. U.S. Trustee, 540 U.S. 526, 534, 124 S. Ct. 1023, 157 L. Ed. 2d 1024, 42 Bankr. Ct. Dec. \(CRR\) 122, 50 Collier Bankr. Cas. 2d \(MB\) 1299, Bankr. L. Rep. \(CCH\) P 80038 \(2004\)](#)); [Crabcake Factory USA, 626 B.R. at 875–76](#).
- 166 [Crabcake Factory USA, 626 B.R. at 876](#). The court cited: [Inhabitants of Montclair Tp. v. Ramsdell, 107 U.S. 147, 152, 2 S. Ct. 391, 27 L. Ed. 431 \(1883\)](#) (“A court should ‘give effect, if possible, to every clause and word of a statute, avoiding, if it may be, any construction which implies that the legislature was ignorant of the meaning of the language it employed.’”); [Hibbs v. Winn, 542 U.S. 88, 101, 124 S. Ct. 2276, 159 L. Ed. 2d 172 \(2004\)](#) (“A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant.”); [Star Athletica, L.L.C. v. Varsity](#)

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[Brands, Inc.](#), 580 U.S. 405, 411, 137 S. Ct. 1002, 197 L. Ed. 2d 354, 122 U.S.P.Q.2d 1001 (2017) (“We thus begin and end our inquiry with the text, giving each word its ‘ordinary, contemporary, common meaning.’” (quoting [Walters v. Metropolitan Educational Enterprises, Inc.](#), 519 U.S. 202, 207, 117 S. Ct. 660, 136 L. Ed. 2d 644, 72 Fair Empl. Prac. Cas. (BNA) 1211, 69 Empl. Prac. Dec. (CCH) P 44411 (1997)); accord, e.g., [Off-Spec Solutions, LLC](#), 651 B.R. at 867, notice of appeal filed, No. 23-60034 (9th Cir., July 20, 2023) (citing [Marx v. General Revenue Corp.](#), 568 U.S. 371, 133 S. Ct. 1166, 185 L. Ed. 2d 242, 84 Fed. R. Serv. 3d 1486 (2013) (“[T]he canon against surplusage is strongest when an interpretation would render superfluous another part of the same statutory scheme.”); [Mackey v. Lanier Collection Agency & Service, Inc.](#), 486 U.S. 825, 837, 108 S. Ct. 2182, 100 L. Ed. 2d 836, 9 Employee Benefits Cas. (BNA) 2129, 28 Wage & Hour Cas. (BNA) 1140, 109 Lab. Cas. (CCH) P 55889 (1988) (“[W]e are hesitant to adopt an interpretation of a congressional enactment which renders superfluous another portion of that same law.”))).

167 E.g., [Off-Spec Solutions, LLC](#), 651 B.R. at 867, notice of appeal filed, No. 23-60034 (9th Cir., July 20, 2023); [GFS Indus., LLC](#), 647 B.R. at 344, notice of appeal filed, No. 23-50237 (5th Cir., April 7, 2023); [Cleary Packaging, LLC](#), 630 B.R. at 472, rev'd, 36 F.4th 509 (4th Cir. 2022).

168 [GFS Indus., LLC](#), 647 B.R. 337, notice of appeal filed, No. 23-50237 (5th Cir. April 7, 2023).

169 [GFS Indus., LLC](#), 647 B.R. at 342, notice of appeal filed, No. 23-50237 (5th Cir. April 7, 2023).

170 For a summary of the provisions of § 1141(d)(6), see supra text accompanying notes 111–114.

171 [GFS Indus., LLC](#), 647 B.R. at 343, notice of appeal filed, No. 23-50237 (5th Cir. April 7, 2023).

172 [GFS Indus., LLC](#), 647 B.R. at 343, notice of appeal filed, No. 23-50237 (5th Cir. April 7, 2023).

173 E.g., [Off-Spec Solutions, LLC](#), 651 B.R. at 867, notice of appeal filed, No. 23-60034 (9th Cir., July 20, 2023); [Cleary Packaging, LLC](#), 630 B.R. at 472, rev'd, 36 F.4th 509 (4th Cir. 2022).

174 [Crabcake Factory USA](#), 626 B.R. at 876 (Bankr. D. Md. 2021).

175 [Cleary Packaging, LLC](#), 630 B.R. at 472, rev'd, 36 F.4th 509 (4th Cir. 2022).

176 [Cleary Packaging, LLC](#), 630 B.R. at 472, rev'd, 36 F.4th 509 (4th Cir. 2022).

177 [Crabcake Factory USA](#), 626 B.R. at 876.

178 [Cleary Packaging, LLC](#), 630 B.R. at 472, rev'd, 36 F.4th 509 (4th Cir. 2022).

179 E.g., [Cleary Packaging, LLC](#), 630 B.R. at 473, rev'd, 36 F.4th 509 (4th Cir. 2022); [Crabcake Factory USA](#), 626 B.R. at 878.

180 E.g., [Crabcake Factory USA](#), 626 B.R. at 876–77 (collecting and discussing cases).

181 See [Cleary Packaging, LLC](#), 630 B.R. at 473–74, rev'd, 36 F.4th 509 (4th Cir. 2022).

182 [Cleary Packaging, LLC](#), 630 B.R. at 474, rev'd, 36 F.4th 509 (4th Cir. 2022).

183 [Cleary Packaging, LLC](#), 630 B.R. at 473 n.12, 474, rev'd, 36 F.4th 509 (4th Cir. 2022) (quoting Brubaker, [Taking Exception](#), 13 AM. BANKR. INST. L. REV. at 764–66); accord, [Off-Spec Solutions, LLC](#), 651 B.R. at 868, notice of appeal filed, No. 23-60034 (9th Cir., July 20, 2023);

184 [Cleary Packaging, LLC](#), 630 B.R. at 475, rev'd, 36 F.4th 509 (4th Cir. 2022).

185 [Section 1141\(d\)\(6\)](#) provides a limited exception for (A) debts of a kind specified in [§ 523\(a\)\(2\)](#) owed to a domestic governmental unit or to a person resulting from an action under the False Claims Act or

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similar state statute and (B) taxes with respect to which the debtor made a fraudulent return or willfully attempted to evade or defeat. See supra text accompanying notes 111–114.

- 186 [Cleary Packaging, LLC, 630 B.R. at 474, rev'd, 36 F.4th 509 \(4th Cir. 2022\).](#)
- 187 [Cleary Packaging, LLC, 630 B.R. at 476, rev'd, 36 F.4th 509 \(4th Cir. 2022\)](#) (quoting [Whitman v. American Trucking Associations, 531 U.S. 457, 468, 121 S. Ct. 903, 149 L. Ed. 2d 1, 51 Env't. Rep. Cas. \(BNA\) 2089, 31 Env't. L. Rep. 20512 \(2001\)](#)).
- 188 [GFS Industries, Inc., 647 B.R. at 349 \(Bankr. W.D. Tex. 2022\)](#), notice of appeal filed, No. 23-50237 (5th Cir., April 7, 2023).
- 189 [Cleary Packaging, LLC, 630 B.R. at 475, rev'd, 36 F.4th 509 \(4th Cir. 2022\).](#)
- 190 [Cleary Packaging, LLC, 630 B.R. at 476, rev'd, 36 F.4th 509 \(4th Cir. 2022\).](#)
- 191 [Cleary Packaging, LLC, 630 B.R. at 476, rev'd, 36 F.4th 509 \(4th Cir. 2022\).](#)
- 192 [Cleary Packaging, LLC, 630 B.R. at 472, rev'd, 36 F.4th 509 \(4th Cir. 2022\).](#)
- 193 [GFS Indus., LLC, 647 B.R. at 345–46](#), notice of appeal filed, No. 23-50237 (5th Cir., April 7, 2023).
- 194 [In re Breezy Ridge Farms, Inc., 2009 WL 1514671 \(Bankr. M.D. Ga. 2009\)](#); [In re JRB Consol., Inc., 188 B.R. 373 \(Bankr. W.D. Tex. 1995\)](#).
- 195 [Cleary Packaging, LLC, 630 B.R. at 472, rev'd, 36 F.4th 509 \(4th Cir. 2022\).](#)
- 196 [Cleary Packaging, LLC, 630 B.R. at 472 & n.9, rev'd, 36 F.4th 509 \(4th Cir. 2022\)](#) (first citing [In re Breezy Ridge Farms, Inc., 2009 WL 1514671](#); and then citing [In re JRB Consol., Inc., 188 B.R. 373 \(Bankr. W.D. Tex. 1995\)](#)). The court in *Crabcake Factory* similarly distinguished the chapter 12 cases. [Crabcake Factory USA, 626 B.R. at 877](#).
- 197 [Cleary Packaging, LLC, 630 B.R. at 472 n.9, rev'd, 36 F.4th 509 \(4th Cir. 2022\)](#) (quoting [In re Hawker Beechcraft, Inc., 515 B.R. 416, 430 \(S.D. N.Y. 2014\)](#)).
- 198 [Cleary Packaging, LLC, 630 B.R. at 472, rev'd, 36 F.4th 509 \(4th Cir. 2022\)](#). *Infra* Section V(B)(5) analyzes the rulings in the chapter 12 cases.
- 199 [Cleary Packaging, LLC, 630 B.R. at 476, rev'd, 36 F.4th 509 \(4th Cir. 2022\).](#)
- 200 [GFS Indus., LLC, 647 B.R. at 345](#), notice of appeal filed, No. 23-50237 (5th Cir., April 7, 2023). The chapter 12 case in its district is [In re JRB Consol., Inc., 188 B.R. 373 \(Bankr. W.D. Tex. 1995\)](#).
- 201 [GFS Indus., LLC, 647 B.R. at 345](#), notice of appeal filed, No. 23-50237 (5th Cir., April 7, 2023).
- 202 [GFS Indus., LLC, 647 B.R. at 345](#), notice of appeal filed, No. 23-50237 (5th Cir., April 7, 2023).
- 203 [GFS Indus., LLC, 647 B.R. at 345–46](#), notice of appeal filed, No. 23-50237 (5th Cir., April 7, 2023).
- 204 [In re Off-Spec Solutions, LLC, 651 B.R. 862, 870–71 \(B.A.P. 9th Cir. 2023\)](#), notice of appeal filed, No. 23-60034 (9th Cir., July 20, 2023).
- 205 [In re Cleary Packaging, LLC, 36 F.4th 509 \(4th Cir. 2022\).](#)

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- [206](#) [Cleary Packaging, LLC, 36 F.4th at 515](#). More accurately, [§ 1192\(2\)](#) governs only one set of exceptions to discharge when the court confirms a cramdown plan under [§ 1191\(a\)](#). It has no application when the court confirms a consensual plan under [§ 1191\(a\)](#).
- [207](#) [Cleary Packaging, LLC, 36 F.4th at 515](#) (emphasis in original).
- [208](#) [Cleary Packaging, LLC, 36 F.4th at 515](#).
- [209](#) [Cleary Packaging, LLC, 36 F.4th at 515](#).
- [210](#) [Cleary Packaging, LLC, 36 F.4th at 515](#).
- [211](#) [Cleary Packaging, LLC, 36 F.4th at 515–16](#).
- [212](#) [Cleary Packaging, LLC, 36 F.4th at 517](#).
- [213](#) [Cleary Packaging, LLC, 36 F.4th at 516](#).
- [214](#) See supra text accompanying notes 111–114 for a summary of [§ 1141\(d\)\(6\)](#).
- [215](#) [Cleary Packaging, LLC, 36 F.4th at 516](#).
- [216](#) Small, [Chapter 12—The Family Farmer Bankruptcy Act of 1986, 1987 ANN. SURV. OF BANKR. LAW 1](#), at part I(A)(8). See supra text accompanying notes 147–149 for a summary of Judge Small's view.
- [217](#) [Cleary Packaging, LLC, 36 F.4th at 516](#).
- [218](#) [Cleary Packaging, LLC, 36 F.4th at 516](#).
- [219](#) [Cleary Packaging, LLC, 36 F.4th at 516](#). An interpretative problem that the Fourth Circuit did not mention is that the bankruptcy courts' interpretation results in debts subject to [§ 1141\(d\)\(6\)](#) being excepted from a corporation's discharge after consensual confirmation, but not after cramdown confirmation. This is because a debtor receives a discharge under [§ 1141\(d\)\(1\)](#) in the consensual situation, which is subject to the [§ 1141\(d\)\(6\)](#) exception, but [§ 1141\(d\)](#) does not apply after cramdown confirmation. Infra Section V(B)(4) addresses both issues in more detail.
- [220](#) [Cleary Packaging, LLC, 36 F.4th at 516](#).
- [221](#) [Cleary Packaging, LLC, at 516](#). Supra Section III(C)(3) discusses the chapter 12 exceptions.
- [222](#) [Cleary Packaging, LLC, 36 F.4th at 516–17](#) (first citing [In re Breezy Ridge Farms, Inc., 2009 WL 1514671, at *6 \(Bankr. M.D. Ga. 2009\)](#); and then citing [JRB Consol., Inc., 188 B.R. at 374](#).
- [223](#) [JRB Consol., Inc., 188 B.R. at 517](#) (quoting [Hall v. U.S., 566 U.S. 506, 519, 132 S. Ct. 1882, 182 L. Ed. 2d 840, 56 Bankr. Ct. Dec. \(CRR\) 122, 67 Collier Bankr. Cas. 2d \(MB\) 459, Bankr. L. Rep. \(CCH\) P 82212, 2012-1 U.S. Tax Cas. \(CCH\) P 50345, 109 A.F.T.R.2d 2012-2020 \(2012\)](#)).
- [224](#) [Cleary Packaging, LLC, 36 F.4th at 517](#).
- [225](#) [Cleary Packaging, LLC, 36 F.4th at 517](#). More precisely, subchapter V makes [§ 1141\(d\)](#) inapplicable when the debtor receives a cramdown discharge, except as provided in [§ 1192, 11 U.S.C.A. § 1181\(c\)](#). [Section 1141\(d\)](#) applies when a debtor receives a discharge after confirmation of a consensual plan, except for [§ 1141\(d\)\(5\)](#) which, in an individual case, provides for deferral of discharge until completion of plan payments, permits a “hardship discharge” and conditions discharge based on matters involving [§ 522\(q\)](#). See infra note 299.

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- [226](#) [Cleary Packaging, LLC, 36 F.4th at 517.](#)
- [227](#) [Cleary Packaging, LLC, 36 F.4th at 517](#) (emphasis in original).
- [228](#) [Cleary Packaging, LLC, 36 F.4th at 517.](#)
- [229](#) [Cleary Packaging, LLC, 36 F.4th at 517](#) (emphasis in original).
- [230](#) [Cleary Packaging, LLC, 36 F.4th at 517.](#)
- [231](#) [Cleary Packaging, LLC, 36 F.4th at 518](#) (emphasis in original).
- [232](#) [In re Cleary Packaging LLC, 630 B.R. 466, 472, 70 Bankr. Ct. Dec. \(CRR\) 112 \(Bankr. D. Md. 2021\), rev'd and remanded, 36 F.4th 509, 515 \(4th Cir. 2022\).](#)
- [233](#) [Cleary Packaging, LLC, 630 B.R. at 476, rev'd 36 F.4th 509 \(4th Cir. 2022\).](#)
- [234](#) [In re Off-Spec Solutions, LLC, 651 B.R. 862 \(B.A.P. 9th Cir. 2023\), notice of appeal filed, No. 23-60034 \(9th Cir., July 20, 2023\); In re 2 Monkey Trading, LLC, 650 B.R. 521, 72 Bankr. Ct. Dec. \(CRR\) 132 \(Bankr. M.D. Fla. 2023\), notice of appeal filed, No. 23-12342 \(11th Cir., July 19, 2023\); In re Hall, 651 B.R. 62 \(Bankr. M.D. Fla. 2023\), In re GFS Industries, LLC, 647 B.R. 337 \(Bankr. W.D. Tex. 2022\), notice of appeal filed, No. 23-60034 \(5th Cir., April 7, 2023\); In re Lapeer Aviation, Inc., 71 Bankr. Ct. Dec. \(CRR\) 112, 2022 WL 1110072 \(Bankr. E.D. Mich. 2022\); In re Rtech Fabrications, LLC, 635 B.R. 559, 568 \(Bankr. D. Idaho 2021\); In re Satellite Restaurants Inc. Crabcake Factory USA, 626 B.R. 871, 70 Bankr. Ct. Dec. \(CRR\) 12 \(Bankr. D. Md. 2021\).](#)
- [235](#) [In re Cleary Packaging, LLC, 36 F.4th 509 \(4th Cir. 2022\).](#)
- [236](#) See, e.g., [Cleary Packaging LLC, 630 B.R. at 472, rev'd, 36 F.4th 509 \(4th Cir. 2022\).](#)
- [237](#) [Cleary Packaging, LLC, 36 F.4th at 515.](#)
- [238](#) [Cleary Packaging, LLC, 36 F.4th at 515.](#)
- [239](#) [Cleary Packaging LLC, 630 B.R. at 472, rev'd 36 F.4th 509 \(4th Cir. 2022\).](#)
- [240](#) See supra text accompanying notes 220–223.
- [241](#) E.g., [Middlesex County Sewerage Authority v. National Sea Clammers Ass'n, 453 U.S. 1, 13, 101 S. Ct. 2615, 69 L. Ed. 2d 435, 16 Env't. Rep. Cas. \(BNA\) 1118, 11 Env'tl. L. Rep. 20684 \(1981\)](#) (“We look first, of course, to the statutory language, particularly to the provisions made therein for enforcement and relief. Then we review the legislative history and other traditional aids of statutory interpretation to determine congressional intent.”) (collecting cases). See [1 NORTON BANKRUPTCY LAW AND PRACTICE § 2:23 \(3d. ed. 2023\)](#) ([T]he courts may look to the legislative history of a statute to determine legislative intent where the plan statutory language is ambiguous, unclear, or open to dispute.”); see also [N.L.R.B. v. United Food and Commercial Workers Union, Local 23, AFL-CIO, 484 U.S. 112, 123, 108 S. Ct. 413, 98 L. Ed. 2d 429, 126 L.R.R.M. \(BNA\) 3281, 107 Lab. Cas. \(CCH\) P 10193 \(1987\)](#) (“On a pure question of statutory construction, our first job is to try to determine congressional intent, using ‘traditional tools of statutory construction.’”); [Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842–843, 104 S. Ct. 2778, 81 L. Ed. 2d 694, 21 Env't. Rep. Cas. \(BNA\) 1049, 14 Env'tl. L. Rep. 20507 \(1984\)](#) (both concerning administrative rulemaking).
- [242](#) [Hamilton v. Lanning, 560 U.S. 505, 517, 130 S. Ct. 2464, 177 L. Ed. 2d 23, 53 Bankr. Ct. Dec. \(CRR\) 67, Bankr. L. Rep. \(CCH\) P 81780 \(2010\)](#) (quoting [Travelers Cas. and Sur. Co. of America v. Pacific Gas and Elec. Co., 549 U.S. 443, 454, 127 S. Ct. 1199, 167 L. Ed. 2d 178, 47 Bankr. Ct. Dec. \(CRR\) 265, 57 Collier Bankr. Cas. 2d \(MB\) 314, Bankr. L. Rep. \(CCH\) P 80880 \(2007\)](#), which quotes [Cohen](#)

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[v. de la Cruz](#), 523 U.S. 213, 221, 118 S. Ct. 1212, 140 L. Ed. 2d 341, 32 Bankr. Ct. Dec. (CRR) 400, 38 Collier Bankr. Cas. 2d (MB) 1891, Bankr. L. Rep. (CCH) P 77644 (1998), quoting [Pennsylvania Dept. of Public Welfare v. Davenport](#), 495 U.S. 552, 110 S. Ct. 2126, 109 L. Ed. 2d 588, 20 Bankr. Ct. Dec. (CRR) 833, 22 Collier Bankr. Cas. 2d (MB) 1067, Bankr. L. Rep. (CCH) P 73382 (1990). Accord, e.g., [Dewsnup v. Timm](#), 502 U.S. 410, 419, 112 S. Ct. 773, 116 L. Ed. 2d 903, 22 Bankr. Ct. Dec. (CRR) 750, 25 Collier Bankr. Cas. 2d (MB) 1297, Bankr. L. Rep. (CCH) P 74361A (1992) (“This Court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history.”); cf. [Kelly v. Robinson](#), 479 U.S. 36, 47, 107 S. Ct. 353, 93 L. Ed. 2d 216, 14 Bankr. Ct. Dec. (CRR) 1383, 14 Bankr. Ct. Dec. (CRR) 1384, 15 Collier Bankr. Cas. 2d (MB) 890, Bankr. L. Rep. (CCH) P 71475 (1986) (“The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific.”), quoting [Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection](#), 474 U.S. 494, 501, 106 S. Ct. 755, 88 L. Ed. 2d 859, 13 Bankr. Ct. Dec. (CRR) 1262, 13 Bankr. Ct. Dec. (CRR) 1269, 13 Collier Bankr. Cas. 2d (MB) 1355, 23 Env’t. Rep. Cas. (BNA) 1913, Bankr. L. Rep. (CCH) P 70923, 16 Env’t. L. Rep. 20278 (1986).

[243](#) See supra notes 106–110 and accompanying text. The referenced notes contain the text of the footnotes to Professor Brubaker's work that document his conclusions regarding Congressional consideration of exceptions to a corporate discharge in a chapter 11 case.

[244](#) Ralph Brubaker, [Taking Exception to the New Corporate Discharge Exceptions](#), 13 AM. BANKR. INST. L. REV. 757, 764 (2005).

[245](#) Ralph Brubaker, [Taking Exception to the New Corporate Discharge Exceptions](#), 13 AM. BANKR. INST. L. REV. 757, 765 (2005) (emphasis in original).

[246](#) Ralph Brubaker, [Taking Exception to the New Corporate Discharge Exceptions](#), 13 AM. BANKR. INST. L. REV. 757, 766 (2005) (quoting 124 CONG. REC. 34,008 (1978) (statement of Sen. DeConcini); 124 CONG. REC. 32,408 (1979) (statement of Rep. Edwards)).

[247](#) See supra Section III(C)(1).

[248](#) [In re GFS Industries, LLC](#), 647 B.R. 337 (Bankr. W.D. Tex. 2022), notice of appeal filed, No. 23-50237 (5th Cir., Apr. 7, 2023).

[249](#) H.R. REP. NO. 116-171, at 7 (2019), as reprinted in 2019 U.S.C.C.A.N. 366, 374.

[250](#) Retired Bankruptcy Judge A. Thomas Small submitted testimony in support of the legislation. Judge Small's explanation of the [§ 1192](#) discharge similarly made no reference to the [§ 523\(a\)](#) exceptions to the discharges of non-individuals. Hearing on Oversight of Bankruptcy Law & Legislative Proposals Before the Subcomm. on Antitrust, Com. & Admin. Law of the H. Comm. on the Judiciary, 116th Cong. 114-22 (2019) (Testimony of A. Thomas Small, Retired Bankruptcy Judge, on behalf of the National Bankruptcy Conference).

[251](#) See supra Section III(C)(1).

[252](#) [Cleary Packaging, LLC](#), 630 B.R. at 475, rev'd, 36 F.4th 509.

[253](#) [Cleary Packaging, LLC](#), 630 B.R. at 475, rev'd, 36 F.4th 509 at 475 (quoting [Whitman v. American Trucking Associations](#), 531 U.S. 457, 468, 121 S. Ct. 903, 149 L. Ed. 2d 1, 51 Env't. Rep. Cas. (BNA) 2089, 31 Env't. L. Rep. 20512 (2001)).

[254](#) [Cleary Packaging, LLC](#), 36 F.4th at 516.

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- [255](#) [Cleary Packaging, LLC, 36 F.4th at 516](#). For a discussion of this part of the court's ruling, see supra text accompanying notes 213–215.
- [256](#) “Beyond removing what was often a meaningless extension of the discharge provisions, the purpose of Code [§ 727\(a\)\(1\)](#) is to avoid the trafficking in corporate shells and in bankrupt partnerships. Consistent with this purpose, the discharge provisions of Chapter 11 similarly deny discharge to debtors who are not individuals if the confirmed Chapter 11 plan provides for the liquidation of all or substantially all of the property of the estate, the debtor does not engage in business after consummation of the plan, and the debtor would be denied a discharge under Code [§ 727\(a\)](#) if the case were a Chapter 7 case.” [4 NORTON BANKRUPTCY LAW AND PRACTICE § 86:2 \(3d. ed. 2023\)](#) (citing [H.R. REP. NO. 95-595](#) (1977), as reprinted in 1978 U.S.C.C.A.N. 5963; [S. REP. NO. 95-989](#) (1978), as reprinted in 1978 U.S.C.C.A.N. 5787).
- [257](#) [11 U.S.C.A. § 1141\(d\)\(3\)](#).
- [258](#) See DRAKE, BONAPFEL AND GOODMAN, CHAPTER 13 PRACTICE AND PROCEDURE § 12:6.
- [259](#) Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, [Pub. L. No. 109-8](#), sec. 708, 119 Stat. 23, 126–27 (2005) (codified as amended at [11 U.S.C.A. § 1141\(d\)\(6\)](#)). See supra text accompanying notes 111–114.
- [260](#) [11 U.S.C.A. § 523\(a\)](#) (emphasis supplied). The reference in [§ 523\(a\)](#) to [§ 1192](#) was made by SBRA. No change to the limiting term “individual debtor” was made by Congress in SBRA or since.
- [261](#) [In re GFS Industries, LLC, 647 B.R. 337 \(Bankr. W.D. Tex. 2022\)](#), notice of appeal filed, No. 23-50237 (5th Cir., April 7, 2023).
- [262](#) [GFS Indus., LLC, 647 B.R. at 343](#), notice of appeal filed, No. 23-50237 (5th Cir., April 7, 2023).
- [263](#) [Cleary Packaging, LLC, 36 F.4th at 516 \(4th Cir. 2022\)](#).
- [264](#) For a discussion of [§ 1141\(d\)\(6\)](#), see supra text accompanying notes 111–114.
- [265](#) For a discussion of this part of the court's ruling, see supra text accompanying notes 217–219.
- [266](#) [Cleary Packaging, LLC, 36 F.4th at 517](#) (distinction between exceptions to discharge in [§ 1192](#) would create “perverse incentives.”).
- Another potentially “perverse incentive,” which the Fourth Circuit did not mention, is that a corporation that liquidates receives a discharge if cramdown confirmation occurs but does not if consensual confirmation occurs. The reason is that [§ 1141\(d\)\(3\)](#), which prohibits discharge of a corporation that liquidates all or substantially all of its assets and does not engage in business after consummation of the plan, applies when the corporation receives a [§ 1141\(d\)](#) discharge after consensual confirmation under [§ 1191\(a\)](#), but [§ 1141\(d\)](#) does not apply when the corporation receives a discharge after cramdown confirmation. [11 U.S.C.A. § 1181\(c\)](#).
- The disparity is not important and makes no difference as a practical matter. A corporation with no assets is not going to engage in postconfirmation business, and the problem that [§ 1141\(d\)\(3\)](#) addresses, which is trafficking in corporate shells, see supra note 256, does not exist in a subchapter V case because a public company is not eligible to be a subchapter V debtor. [11 U.S.C.A. § 1182\(l\)\(b\)\(ii\)](#).
- [267](#) A tailored Westlaw search for use of the term “1141(d)(6)” returns a result of 49 cases, most of which mention the statute in passing or as a part of boilerplate plan language. The few cases with substantive discussions did not conclude that [§ 1141\(d\)\(6\)](#) applies. The only case finding a corporate debt excepted from discharge under [§ 1141\(d\)\(6\)](#) is [In re Fusion Connect, Inc., 634 B.R. 22, 70 Bankr. Ct. Dec. \(CRR\)](#)

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[167 \(S.D. N.Y. 2021\)](#) (holding that a civil penalty owed to the United States based on fraud on consumers was excepted under [§ 1141\(d\)\(6\)\(A\)](#) as a debt “of a kind” specified in [§ 523\(a\)\(2\)\(A\)](#)).

[268](#) See supra text accompanying notes 111–114.

[269](#) Infra Section V(B)(5) discusses interpretation of § 1192(2) and § 523(a) in the context of the enactment of chapter 12.

[270](#) Accord, [GFS Indus., LLC](#), 647 B.R. at 349–50, notice of appeal filed, No. 23-50237 (5th Cir., April 7, 2023).

[271](#) [In re Breezy Ridge Farms, Inc.](#), 2009 WL 1514671 (Bankr. M.D. Ga. 2009); [In re JRB Consol., Inc.](#), 188 B.R. 373 (Bankr. W.D. Tex. 1995).

[272](#) [In re Cleary Packaging, LLC](#), 36 F.4th 509 (4th Cir. 2022).

In [In re JRB Consol., Inc.](#), 188 B.R. 373 (Bankr. W.D. Tex. 1995), the court reasoned that the operative language in [§ 1228\(a\)\(2\)](#) (“debts of the kind” specified in [§ 523\(a\)](#)) “does not naturally lend itself to also incorporate the meaning ‘for debtors of the kind’ referenced in [§ 523\(a\)](#).” 188 B.R. at 374. Instead, the court concluded, “debts of the kind” is limited to the types of debts that the subparagraphs of [§ 523\(a\)](#) identify. 188 B.R. at 374. Moreover, the court explained, [§ 1228\(a\)](#), unlike [§ 1141\(d\)](#), does not expressly provide a broader discharge for corporations than for individuals. 188 B.R. at 374.

The court in [In re Breezy Ridge Farms, Inc.](#), 2009 WL 1514671 (Bankr. M.D. Ga. 2009); adopted the same reasoning. In addition, the court noted that the exceptions to discharge for a corporation in [§ 1141\(d\)\(6\)](#) apply to debts “of a kind specified in paragraph (2)(A) or (2)(B) of section 523(a)” that meet certain other requirements even though corporate debtors are excluded from [§ 523\(a\)](#) by its terms. 2009 WL 1514671 at *2. The [Breezy Ridge Farms](#) court explained that its interpretation harmonized the provisions of [§ 1228](#) and [§ 523\(a\)](#):

Although [§ 523\(a\)](#) applies only to individuals, Congress has used it as shorthand to define the scope of a Chapter 12 discharge for corporations as well as individuals. Thus, it is appropriate to rely on [§ 523\(a\)](#) to determine whether a debt is included in the discharge, even when the debtor is a corporation. Even if the two provisions could not be harmonized, [§ 1228](#) would control because it is more specific, applicable only in Chapter 12, than [§ 523\(a\)](#), which applies regardless of chapter.

[2009 WL 1514671 at *2](#).

Judge Small anticipated the rulings and reasons for them in his 1987 work on chapter 12. Small, [Chapter 12—The Family Farmer Bankruptcy Act of 1986](#), 1987 ANN. SURV. OF BANKR. LAW 1. See supra text accompanying notes 141–148.

[273](#) For a discussion of this part of the court’s ruling, see supra text accompanying notes 220–223.

[274](#) To support its observation that chapter 12 and subchapter V are “conceptually similar,” the Fourth Circuit cited [In re Trepetin](#) as “recognizing that ‘several aspects of Subchapter V are premised on the provisions of chapter 12 ...’” [Cleary Packaging, LLC](#), 36 F.4th at 516 (quoting [In re Trepetin](#), 617 B.R. 841, 848 (Bankr. D. Md. 2020)). The [Trepetin](#) analysis was more nuanced:

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Subchapter V and chapter 12 are not identical, and invoking chapter 12 standards may not be warranted in every instance. Subchapter V starts with chapter 11 as its base and then draws on the structure of chapter 12, certain elements of chapter 13, and the recommendations of the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 and the National Bankruptcy Conference.

[617 B.R. 841 at 848, n.14 \(Bankr. D. Md. 2020\).](#)

[275](#) Compare [11 U.S.C.A. § 1183](#), with [11 U.S.C.A. § 1202](#).

[276](#) Compare [11 U.S.C.A. § 1191\(b\)\(2\)](#), with [11 U.S.C.A. 1228\(a\)](#)

[277](#) [Cleary Packaging, LLC](#), 630 B.R. at 472 & n.9 (Bankr. D. Md. 2021), rev'd, 36 F.4th 509 (4th Cir. 2022). The court in *Crabcake Factory* similarly distinguished the chapter 12 cases. [In re Satellite Restaurants Inc. Crabcake Factory USA](#), 626 B.R. 871, 877, 70 Bankr. Ct. Dec. (CRR) 12 (Bankr. D. Md. 2021). For a discussion of the bankruptcy court's rationale in *Cleary Packaging*, see supra text accompanying notes 192–199.

[278](#) [Cleary Packaging, LLC](#), 630 B.R. at 472 n.9, rev'd, 36 F.4th 509 (4th Cir. 2022) (quoting [In re Hawker Beechcraft, Inc.](#), 515 B.R. 416, 430 (S.D. N.Y. 2014)).

[279](#) [In re GFS Industries, LLC](#), 647 B.R. 337, 345 (Bankr. W.D. Tex. 2022), notice of appeal filed, No. 23-50237 (5th Cir., April 7, 2023). For a discussion of the *GFS Industries* rationale, see supra text accompanying notes 200–204.

[280](#) [In re JRB Consol., Inc.](#), 188 B.R. 373 (Bankr. W.D. Tex. 1995).

[281](#) [GFS Indus., LLC](#), 647 B.R. at 345–46, notice of appeal filed, No. 23-50237 (5th Cir., April 7, 2023).

[282](#) [Cleary Packaging, LLC](#), 630 B.R. at 472, rev'd, 36 F.4th 509 (4th Cir. 2022).

[283](#) [In re Off-Spec Solutions, LLC](#), 651 B.R. 862, 870–71 (B.A.P. 9th Cir. 2023), notice of appeal filed, No. 23-60034 (9th Cir., July 20, 2023).

[284](#) None of the subchapter V cases consider the legislative history of chapter 12, either.

[285](#) 132 CONG. REC. 9779, 9898 (1986) (emphasis added). The analysis is of S.B. 1923, which eventually made its way into the legislation that the Senate passed to replace HR. 2211. The discharge provisions in S.B. 1923 were in § 1219, which became § 1228 in the enacted legislation. See supra note 142.

[286](#) See supra text accompanying notes 130–133.

[287](#) See Small, [Chapter 12—The Family Farmer Bankruptcy Act of 1986](#), 1987 ANN. SURV. OF BANKR. LAW 1, at part I(A)(8). See supra text accompanying notes 147–148.

[288](#) E.g., [Ransom v. FIA Card Services, N.A.](#), 562 U.S. 61, 71, 131 S. Ct. 716, 178 L. Ed. 2d 603, 54 Bankr. Ct. Dec. (CRR) 34, 64 Collier Bankr. Cas. 2d (MB) 1123, Bankr. L. Rep. (CCH) P 81914 (2011).

[289](#) [Cleary Packaging, LLC](#), 36 F.4th at 517.

[290](#) [36 F.4th at 517.](#)

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- [291](#) [36 F.4th at 517.](#)
- [292](#) [Section 1141\(d\)\(5\)](#), which applies only to individuals, makes three other distinctions between the discharges of individuals and corporations. It is inapplicable in a subchapter V case. [11 U.S.C.A. § 1181\(a\)](#). First, the section provides for deferral of an individual's discharge until completion of plan payments. Second, it permits the grant of a so-called “hardship discharge” under certain conditions for an individual debtor who has not completed plan payments. Finally, the statute conditions an individual's discharge on findings by the court (1) that there is no reasonable cause to believe that [11 U.S.C.A. § 522\(q\)\(1\)](#) is applicable and (2) that no proceeding is pending in which the debtor may be found guilty of a felony as described in [§ 522\(q\)\(1\)\(A\)](#) or liable for a debt as described in [§ 522\(q\)\(1\)\(B\)](#).
- Similar provisions with regard to [§ 522\(q\)](#) apply to the grant of the discharge under chapters 7, 12, and 13. See 7 [11 U.S.C.A. §§ 727\(a\)\(12\), 1228\(f\), 1328\(h\)](#). For a discussion of the chapter 13 provision, see DRAKE, BONAPFEL AND GOODMAN, CHAPTER 13 PRACTICE AND PROCEDURE § 21:5.
- [Section 522\(q\)\(1\)](#) limits the value of the exemption an individual debtor utilizing the non-bankruptcy exemptions under [§ 522\(b\)\(3\)\(A\)](#) may take in a residence, homestead, of burial plot if the debtor has committed a felony that, under the circumstances, demonstrates that the filing of the case is an abuse of the Bankruptcy Code or if the debtor owes a debt arising from a violation of state or federal securities laws, from any civil remedy under [18 U.S.C.A. § 1964](#), or from any criminal act, intentional tort, or willful misconduct that caused serious physical injury or death to another individual, in the preceding five years.
- [293](#) See supra Section III(C)(1).
- [294](#) [Cleary Packaging, LLC, 36 F.4th at 517.](#)
- [295](#) [36 F.4th at 517.](#)
- [296](#) [36 F.4th at 517.](#)
- [297](#) See supra Section V(B)(1).
- [298](#) See supra Section III(C)(1).
- [299](#) Infra Section V(B)(7)(b) discusses the point in detail.
- [300](#) See supra Section III(C)(1).
- [301](#) [Cleary Packaging, LLC, 36 F.4th at 517–18](#). For a discussion of this part of the court's ruling, see supra text accompanying notes 228–230.
- [302](#) [Cleary Packaging, LLC, 36 F.4th at 517.](#)
- [303](#) [11 U.S.C.A. § 1191\(c\)\(2\)](#). See generally Bonapfel, A Guide to the SBRA, supra note 12, at 141–49 (rev. ed. June 2022), available at https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf.
- [304](#) [11 U.S.C.A. § 1191\(c\)\(3\)](#). See generally Bonapfel, A Guide to the SBRA, at 156–60 (rev. ed. June 2022), available at https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf.
- [305](#) [11 U.S.C.A. § 1191\(c\)](#).
- [306](#) The priority discussion here involves only the priority of unsecured creditors over equity interests. Although a secured creditor has a “priority” over unsecured creditors in that it has collateral to secure its debt, and unsecured creditors in a liquidation case cannot generally be paid from the liquidation of a creditor's collateral until the secured creditor receives full payment, that type of “priority” is irrelevant to the absolute priority rule. Priority claims under [11 U.S.C.A. § 507](#) are likewise irrelevant to the issue

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because they must be paid in full. [11 U.S.C.A. § 1129\(a\)\(9\)](#). For simplicity, the discussion does not include consideration of issues that arise when one class of unsecured creditors is subordinated to the claims of another unsecured class.

[307](#) [Cleary Packaging, LLC](#), 630 B.R. at 474, rev'd, [36 F.4th 509 \(4th Cir. 2022\)](#) (quoting Ralph Brubaker, [Taking Exception to the New Corporate Discharge Exceptions](#), 13 AM. BANKR. INST. L. REV. 757, 764–66 (2005)); accord, e.g., [In re Off-Spec Solutions, LLC](#), 651 B.R. 862 (B.A.P. 9th Cir. 2023), notice of appeal filed, No. 23-60034 (9th Cir., July 20, 2023).

[308](#) See [In re Corinthian Communications, Inc.](#), 642 B.R. 224, 225 (Bankr. S.D. N.Y. 2022) (“It is often the debtor's owner who built the business—developing and maintaining relationships with employees, customers and vendors that give the debtor a chance at successfully reorganizing. Remove the owner's authority to manage the business as a debtor in possession, and the debtor is more likely to fail.”)

[309](#) See [In re Moore Properties of Person County, LLC](#), 68 Bankr. Ct. Dec. (CRR) 123, 2020 WL 995544, at *5 (Bankr. M.D. N.C. 2020).

[310](#) [Cleary Packaging, LLC](#), 36 F.4th at 517.

[311](#) [Cleary Packaging, LLC](#), 36 F.4th at 517.

[312](#) [11 U.S.C.A. § 1191\(c\)\(3\)](#); See generally Bonapfel, A Guide to the SBRA, supra note 12, at 141–55 (rev. ed. June 2022), available at https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf.

[313](#) [In re Moore Properties of Person County, LLC](#), 68 Bankr. Ct. Dec. (CRR) 123, 2020 WL 995544, at *5 (Bankr. M.D. N.C. 2020).

[314](#) [Cleary Packaging, LLC](#), 36 F.4th at 517.

[315](#) The general rule in chapter 13 cases is that a plan must treat a nondischargeable claim in the same manner as other unsecured claims. See DRAKE, BONAPFEL AND GOODMAN, CHAPTER 13 PRACTICE AND PROCEDURE §§ 7:10–7:14.

[316](#) See supra Section III(C)(1).

[317](#) The example approximates the unsecured debt listed in Schedule E/F and the projected disposable income in the proposed subchapter V plan filed in the *Cleary Packaging* case at the time of the bankruptcy court's decision. The debtor in its plan projected approximately \$280,000 in projected disposable income over five years for distribution to unsecured creditors after payment of secured and priority claims. Debtor's Amended Chapter 11, Subchapter V Plan of Reorganization, *In re Cleary Packaging Co.*, Case No. 21-10765-MHH, ECF No. 124 (Aug. 20, 2021) (Appendix 2 at 32). Schedule E/F listed unsecured claims of approximately \$5 million, excluding unsecured claims of the principal to be subordinated and a PPP loan to be forgiven. Schedules A-H, *In re Cleary Packaging Co.*, Case No. 21-10765-MHH, ECF No. 25 (Feb. 25, 2021).

[318](#) An owner might sign on for this type of work if the individual is also liable on a nondischargeable debt. In the case of a closely held corporation, it is likely that the owner is liable because of his personal conduct, so the debt will be nondischargeable in the owner's bankruptcy case. In such a situation, however, the problem of dealing with the nondischargeable debt should be the owner's, not the corporation's or its creditors'.

With regard to the *Cleary Packaging* case, the creditor filed a complaint to determine the nondischargeability of its judgment against the principal in the principal's subchapter V case. *Cantwell Cleary Co. v. Vincent D. Cleary, Jr.*, Adv. Proc. No.21-00272-NVA, ECF No. 1 (Dec. 27, 2021).

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- [319](#) Ralph Brubaker, [Taking Exception to the New Corporate Discharge Exceptions](#), 13 AM. BANKR. INST. L. REV. 757 (2005), discussed supra in text accompanying notes 98–110.
- [320](#) Ralph Brubaker, [Taking Exception to the New Corporate Discharge Exceptions](#), 13 AM. BANKR. INST. L. REV. 757, 764 (2005), discussed supra in text accompanying notes 98–110.
- [321](#) This consideration may have been of no concern to the creditor in *Cleary Packaging*. An employee of the creditor, apparently related to some of the creditor's former owners, left to organize the debtor and compete with it, resulting in litigation and a judgment against the debtor and the former employee for over \$4.7 million. The creditor's objective in the subchapter V case could have been to put a competitor out of business through liquidation.
- [322](#) [Cleary Packaging, LLC](#), 36 F.4th at 518.
- [323](#) [Local Loan Co. v. Hunt](#), 292 U.S. 234, 244, 54 S. Ct. 695, 78 L. Ed. 1230, 93 A.L.R. 195 (1934).
- [324](#) See Ralph Brubaker, [Taking Exception to the New Corporate Discharge Exceptions](#), 13 AM. BANKR. INST. L. REV. 757 (2005). Professor Brubaker discusses this point in detail at 761–62.
- [325](#) See supra Section V(B)(7)(b).
- [326](#) See supra Section III(C)(1).
- [327](#) [Local Loan Co. v. Hunt](#), 292 U.S. at 244.
- [328](#) See Ralph Brubaker, [Taking Exception to the New Corporate Discharge Exceptions](#), 13 AM. BANKR. INST. L. REV. 757 (2005). Professor Brubaker discusses this point in detail at 761–62.
- [329](#) [In re Off-Spec Solutions, LLC](#), 651 B.R. 862 (B.A.P. 9th Cir. 2023), notice of appeal filed, No. 23-60034 (9th Cir., July 20, 2023); [In re 2 Monkey Trading, LLC](#), 650 B.R. 521, 72 Bankr. Ct. Dec. (CRR) 132 (Bankr. M.D. Fla. 2023), notice of appeal filed, No. 23-12342 (11th Cir., July 19, 2023); [In re Hall](#), 651 B.R. 62 (Bankr. M.D. Fla. 2023), [In re GFS Industries, LLC](#), 647 B.R. 337 (Bankr. W.D. Tex. 2022), notice of appeal filed, No. 23-60034 (5th Cir., April 7, 2023); [In re Lapeer Aviation, Inc.](#), 71 Bankr. Ct. Dec. (CRR) 112, 2022 WL 1110072 (Bankr. E.D. Mich. 2022); [In re Rtech Fabrications, LLC](#), 635 B.R. 559 (Bankr. D. Idaho 2021); [In re Cleary Packaging LLC](#), 630 B.R. 466, 472, 70 Bankr. Ct. Dec. (CRR) 112 (Bankr. D. Md. 2021), rev'd and remanded, 36 F.4th 509, 515 (4th Cir. 2022); [In re Satellite Restaurants Inc. Crabcake Factory USA](#), 626 B.R. 871, 878, 70 Bankr. Ct. Dec. (CRR) 12 (Bankr. D. Md. 2021). See supra Section IV(A).
- [330](#) [Cleary Packaging LLC](#), 36 F.4th at 515. See supra Section IV(B).
- [331](#) [Cleary Packaging LLC](#), 36 F.4th at 512.
- [332](#) [Cleary Packaging LLC](#), 36 F.4th at 512.
- [333](#) See cases cited supra notes 241–242, 287.
- [334](#) See supra Section III(C)(1).
- [335](#) See supra Sections II(A), V(B)(1).
- [336](#) Cf. cases cited supra note 242.
- [337](#) Cf. [Ransom v. FIA Card Services, N.A.](#), 562 U.S. 61, 71, 131 S. Ct. 716, 178 L. Ed. 2d 603, 54 Bankr. Ct. Dec. (CRR) 34, 64 Collier Bankr. Cas. 2d (MB) 1123, Bankr. L. Rep. (CCH) P 81914 (2011).

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- [338](#) Accord [GFS Industries, LLC](#), 647 B.R. at 349, notice of appeal filed, No. 23-50237 (5th Cir., April 7, 2023) (“The idea that Congress would aim to create a simpler option for a corporation to pursue bankruptcy while simultaneously implementing impediments to that debtor achieving a discharge of debts defies reason.”).
- [339](#) See supra Sections III(D), V(B)(2).
- [340](#) H.R. REP. No. 116-171 at 8.
- [341](#) [Cleary Packaging, LLC](#), 630 B.R. at 475, rev'd, 36 F.4th 509 (4th Cir. 2022), quoting [Whitman v. American Trucking Associations](#), 531 U.S. 457, 468, 121 S. Ct. 903, 149 L. Ed. 2d 1, 51 Env't. Rep. Cas. (BNA) 2089, 31 Env'tl. L. Rep. 20512 (2001).
- [342](#) See supra Sections III(C)(1), V(B)(1).

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DEFAMATION, BANKRUPTCY & THE FIRST AMENDMENT

*Christopher D. Hampson**

In recent years, a series of high-profile defamation cases has wound up in bankruptcy court, involving such colorful characters as Rudy Giuliani, Alex Jones, and Cardi B. As demands and verdicts swell with the rise of social media in a polarized age, defamation defendants are filing bankruptcy more frequently and at earlier stages of litigation. But that doesn't mean bankruptcy is a magic wand for waving away debt. To the contrary, much defamation debt may be nondischargeable as "willful and malicious" under section 523 of the Bankruptcy Code. Of course, consumer bankruptcy attorneys are all too familiar with bankruptcy's discharge exceptions, but some courts are now starting to apply the exceptions to small businesses attempting to reorganize under subchapter V of the Code—a category that includes Alex Jones's InfoWars.

Defamation law is coming to bankruptcy court, and it's bringing the First Amendment with it. Yet scholars and practitioners have not yet placed these three areas of law—defamation, bankruptcy, and the First Amendment—next to each other. This Article provides both theoretical and practical guidance to litigants and lawyers, showing how bankruptcy's substantive and procedural rules will process defamation debt, including when the

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First Amendment protections of *New York Times v. Sullivan* and related cases are triggered. The ensuing mixture is a cocktail of torts, contracts, civil procedure, federal courts, and constitutional law.

When speech injures others, compensation and punishment are in order. Yet forgiveness and a fresh start have their place as well. As to individuals, defamation debt should cause us to reflect on whether our “fresh start” policy in bankruptcy is too anemic. As to business entities, the defamation cases continue to raise the specter of whether chapter 11 makes it too easy for bad actors to shed debt without compensating victims, suffering consequences, or reforming behavior. Either way, attorneys must be prepared to provide forward-thinking legal advice about bankruptcy whenever insolvency is on the horizon.

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INTRODUCTION

In recent years, a series of high-profile defamation cases has wound up in bankruptcy court, involving such colorful characters as mayor-turned-MAGA Rudy Giuliani, polemic radio host Alex Jones, and pathbreaking rapper Cardi B. As demands and verdicts swell with the rise of social media in a polarized age, defamation defendants are filing bankruptcy more frequently and at earlier stages of litigation. But that doesn't mean bankruptcy is a magic wand for waving away debt. To the contrary, much defamation debt (an umbrella term covering slander, libel, false light, and invasion of privacy) may be nondischargeable as "willful and malicious" under section 523 of the Bankruptcy Code.¹ Of course, consumer bankruptcy attorneys are all too familiar with bankruptcy's discharge exceptions, but some courts (most notably the Fourth and Fifth Circuits) are now starting to apply the exceptions to small businesses reorganizing under subchapter V of the Code²—a category that includes Alex Jones's InfoWars.

Defamation law is coming to bankruptcy court, and it's bringing the First Amendment with it. Yet scholars and practitioners have not yet placed these three areas of law—defamation, bankruptcy, and the First Amendment—next to each other. To be sure, the scholarly literature contains a robust discussion of bankruptcy's discharge exceptions, including incisive analyses by Professors Abbye Atkinson³ and Nicole Langston,⁴ who have pointed out structural ways that the dis-

¹ 11 U.S.C. §§ 101 *et seq.*; 11 U.S.C. § 523(a).

² See *Cantwell-Cleary Co., Inc. v. Cleary Packaging, LLC* (*In re Cleary Packaging, LLC*), 36 F.4th 509, 512 (4th Cir. 2022); *Avion Funding, LLC v. GFS Indus., LLC* (*In re GFS Indus., LLC*), 99 F.4th 223, 232 (5th Cir. 2024). By contrast, every bankruptcy court to consider the issue has reached the opposite conclusion. See *infra* notes 142–143 and accompanying text.

³ See Abbye Atkinson, *Race, Educational Loans, & Bankruptcy*, 16 MICH. J. RACE & L. 1, 12–25 (2010) (presenting empirical research into bankruptcy filing rates by college education and race, and arguing that the benefits of a college education are not equally accessible to Americans of all racial backgrounds); Abbye Atkinson, *Consumer Bankruptcy, Nondischargeability, and Penal Debt*, 70 VAND. L. REV. 917, 945–65 (2017) (criticizing bankruptcy's discharge exceptions as "arbitrary line-drawing" with "negative implications for economically and socially disenfranchised communities").

⁴ Nicole Langston, *Discharge Discrimination*, 111 CALIF. L. REV. 1031, 1156–66 (2023) (analyzing how the discharge exceptions of the Bankruptcy Code structurally protect institutions like the police while subordinating debtors subject to their surveillance activity).

charge exceptions deepen disparate treatment along race and class lines. The conversation is particularly rigorous and longstanding with respect to student loans, both among academics and the public.⁵ And the discharge exceptions recently came before the Supreme Court in *Bartenwerfer v. Buckley*,⁶ foreshadowing tough questions about what Professor Angela Littwin calls “coerced debt” in the context of abusive and violent domestic relationships.⁷

On another front, Professors Pamela Foohey and Christopher Odinet have uncovered how large debtors use bankruptcy to silence plaintiffs in the context of “onslaught litigation”—discussing asbestos and breast implant product liability, the Catholic Church, and Alex Jones.⁸ And legal scholar Adi Marcovich Gross has analyzed how bankruptcy discharge rules weaken key incentives to monitor for sexual misconduct.⁹

How and when defamation debt is nondischargeable, though, has received relatively less attention.¹⁰ Attorneys Michael Traison, Michael Kwiatkowski, and Samantha Giuglianotti recently analyzed these issues in the context of the defamation

⁵ See, e.g., John Patrick Hunt, *Tempering Bankruptcy Nondischargeability to Promote the Purposes of Student Loans*, 72 SMU L. REV. 725, 729–30 (2019) (arguing that the stringent requirements for student loan dischargeability fit poorly with the goals of the student-loan program); John A.E. Pottow, *The Nondischargeability of Student Loans in Personal Bankruptcy Proceedings: The Search for a Theory*, 44 CAN. BUS. L.J. 245, 246–47 (2006) (critiquing the Bankruptcy Code’s treatment of student loans and advocating for an income-contingent approach). In 2022, the Department of Education and the Department of Justice issued new guidance concerning when the U.S. government would object to the discharge of student loans, developing a more debtor-friendly test than the prevailing caselaw as well as procedures for a settled outcome in bankruptcy court. See DEP’T OF JUST., GUIDANCE FOR DEPARTMENT ATTORNEYS REGARDING STUDENT LOAN BANKRUPTCY LITIGATION (Nov. 17, 2022), <https://perma.cc/QP68-DR6F>.

⁶ 598 U.S. 69 (2023).

⁷ Angela Littwin, *Escaping Battered Credit: A Proposal for Repairing Credit Reports Damaged by Domestic Violence*, 161 U. PA. L. REV. 363, 365 (2013); Angela Littwin, *Coerced Debt: The Role of Consumer Credit in Domestic Violence*, 100 CALIF. L. REV. 951, 957–59 (2012).

⁸ Pamela Foohey & Christopher K. Odinet, *Silencing Litigation Through Bankruptcy*, 109 VA. L. REV. 1261, 1296–1312 (2023).

⁹ Adi Marcovich Gross, *Morally Bankrupt: Bankruptcy Law, Corporate Responsibility, and Sexual Misconduct*, 97 AM. BANKR. L.J. 480, 508–521 (2023).

¹⁰ A 1995 article discussed defamation debt in the context of section 523(a)(6) but did not analyze the First Amendment. See generally George M. Ahrend & Randall T. Thomsen, *Tort Claims and Judgements as Debts for Willful and Malicious Injury Nondischargeable under Section 523(a)(6) of*

litigation between actors Johnny Depp and Amber Heard.¹¹ Pointing out that the jury found that Heard’s defamation was made with “actual malice,” the authors correctly note that the First Amendment test is insufficient to meet the bankruptcy test for dischargeability.¹² A leading defamation treatise by Judge Robert Sack and Professor Lyriisa Lidsky lays out the basic framework and remarks that there are “blessedly few cases addressing the issue.”¹³ As we enter a new era of defamation debt, our analytical framework may be too flimsy to handle the growing flow of cases.

This Article provides both theoretical and practical guidance to litigants and lawyers, showing how bankruptcy’s substantive and procedural rules will process defamation debt, including when the First Amendment protections of *New York Times Company v. Sullivan*¹⁴ and related cases are triggered. The ensuing mixture is a cocktail of torts, contracts, civil procedure, federal courts, and constitutional law.

The Article proceeds in four parts. In Part I, I explore the cases that establish the defamation-to-bankruptcy trendline, as well as analyze doctrinal and legislative changes that may crystallize this pattern. In Part II, I discuss bankruptcy’s discharge exceptions and explain how bankruptcy courts determine which debts are unfor-giveable in bankruptcy. In Part III, I place those rules alongside the First Amend-ment’s rules for liability, exploring how the Bankruptcy Code can burden speech and is therefore subject to First Amendment scrutiny. Finally, in Part IV, I provide pragmatic advice to plaintiff-side and defendant-side defamation attorneys and

the Bankruptcy Code, 100 COM. L.J. 498 (1995) (discussing the standard for willful and malicious injury under section 523(a)(6) of the Code). Bankruptcy and defamation have, of course, intersected in other ways. In *Moe v. Wise*, a former business owner attempted to sue the new CEO and the bankruptcy attorney after they sent a disparaging letter to the company’s creditors. See 989 P.2d 1148, 1155–57 (Wash. Ct. App. 1999). And the famous Supreme Court case *Dun & Bradstreet* involved a credit reporting agency that was sued for defamation after it mistakenly reported to its subscribers that a construction contractor had filed for bankruptcy. See *Dun & Bradstreet, Inc. v. Greenmoss Builders, Inc.*, 472 U.S. 749, 751 (1985).

¹¹ Michael H. Traison, Michael Kwiatkowski & Samantha Giuglianotti, *The Continuing Saga of Amber Heard and Johnny Depp*, 41 AM. BANKR. INST. J. 18, 18–19, 29 (2022).

¹² *Id.* at 19.

¹³ ROBERT D. SACK & LYRISSA BARNETT LIDSKY, SACK ON DEFAMATION: LIBEL, SLANDER, AND RELATED PROBLEMS § 10:7 (5th ed. 2024).

¹⁴ 376 U.S. 254 (1964).

present some systemic concerns from the bankruptcy point of view. How we treat defamation debt in bankruptcy triggers the policies behind both free speech law and bankruptcy law.

I. THE DEFAMATION-TO-BANKRUPTCY PIPELINE

The trend of defamation cases heading to bankruptcy court has garnered the attention of both journalists and scholars, a trend I have previously called a “defamation-to-bankruptcy pipeline.”¹⁵ In this Part, I recount the plot points that establish the trend and discuss where we might be headed next.

A. *A Groundswell of Defamation Liability*

Defamation exposure appears to be growing. To be fair, measuring that growth is hard to do: The numbers are scattered across jury verdicts, settlement amounts, and demand letters. Legal observers have noted that demand amounts have increased in recent years¹⁶ and that the claims themselves have taken on a distinct politicized hue.¹⁷ Plaintiffs may have any number of goals in such suits, such as silencing critics, attracting media attention, refuting misinformation, or seeking

¹⁵ See James Nani, *Giuliani Joins Alex Jones in Defamation-to-Bankruptcy Pipeline*, BLOOMBERG L. (Dec. 22, 2023, 5:00 AM) (quoting author), <https://perma.cc/X8DC-K6TV>.

¹⁶ See Mark Curriden, *The Defame Game: Libel Cases Are on the Rise and Increasingly Politicized*, A.B.A. J. (Oct. 1, 2023, 12:00 AM), <https://perma.cc/A3N7-QMBK>.

¹⁷ It is increasingly common for political actors to be plaintiffs or defendants in defamation cases, as well as for individual journalists to be named in complaints. See *id.* Political defamation cases include Alex Jones and Rudy Giuliani, discussed below, as well as many others. Former GOP Congressman Devin Nunes has brought several of these cases, as has Donald Trump. See *id.* For example, in 2022, former Alaska governor and vice-presidential candidate Sarah Palin sued *The New York Times* for linking her campaign rhetoric to a 2011 mass shooting in Arizona. See First Am. Compl., *Palin v. New York Times Co.*, No. 17 Civ. 4853 (S.D.N.Y. Dec. 30, 2019), ECF No. 70, 2019 WL 11616892; *Palin v. New York Times Co.*, 940 F.3d 804 (2d Cir. 2019) (vacating dismissal and remanding); *Palin v. New York Times Co.*, 113 F.4th 245 (2d Cir. 2024) (vacating and remanding for new trial). And after the 2020 presidential election, voting machine firms Dominion and Smartmatic sued Fox News, One America News Network, Newsmax, and several Republican pugilists for accusing them of surreptitiously delivering the 2020 election to President Joe Biden through faulty or compromised voting machines. See Compl., *US Dominion, Inc. v. Fox News Network, LLC*, No. N21C-03-257 (Del. Super. Ct. Mar. 26, 2021), 2021 WL 1153152. In April 2023, Fox News settled with Dominion for \$787.5 million—and the remaining cases are similarly massive. See *US Dominion, Inc. v. Fox News Network, LLC*, No. N21C-03-257 (Del. Super. Ct. Apr. 19, 2023) (dismissed with prejudice); see also, e.g., Compl. and Demand for Jury Trial, *Smartmatic USA Corp. v. Herring Networks, Inc.*, No. 1:21-cv-02900 (D.D.C. Nov. 3, 2021), ECF No. 1, 2021 WL 5121115.

compensation for harm. And in several of these cases, the defamation defendant has faced financial distress in the wake of the litigation.

Some examples in the defamation-to-bankruptcy pipeline involve lies peddled by big players. Rudy Giuliani, once dubbed “America’s mayor” for his role as head of New York City in the wake of 9/11, threw in his lot with Donald Trump during the 2016 and 2020 presidential campaigns.¹⁸ After Joe Biden won the 2020 election, Giuliani accused two Georgia election workers of rigging the Fulton County vote in favor of Biden. The election workers, Ruby Freeman and Shaye Moss, faced an “immediate onslaught of violent and racist threats and harassment.”¹⁹ They sued Giuliani for defamation, intentional infliction of emotional distress (“IIED”), and civil conspiracy.²⁰ On December 15, 2023, a D.C. jury awarded Freeman and Moss \$148 million in damages.²¹ On December 20, the judge ruled that the plaintiffs could begin seizing Giuliani’s nonexempt assets.²²

The next day, Giuliani filed for bankruptcy in New York, pausing collection efforts pursuant to bankruptcy’s automatic stay.²³ While Giuliani used social media to spread the “Big Lie,” his capacity and credibility were predicated on his celebrity status: the former mayor of America’s largest city and legal counsel to a presidential candidate.²⁴ Giuliani’s bankruptcy case ended ignominiously. On July 12, 2024, the

¹⁸ See, e.g., Michael R. Sisak, *The Fall of Rudy Giuliani: How “America’s Mayor” Tied His Fate to Donald Trump and Got Indicted*, AP NEWS (Aug. 17, 2023, 5:22 PM), <https://perma.cc/A23C-J74L>.

¹⁹ Am. Compl. at ¶ 14, *Freeman v. Giuliani*, No. 21-cv-03354 (D.D.C. May 10, 2022), ECF No. 22.

²⁰ *Id.* at ¶¶ 14, 163–177, 178–186, 187–191.

²¹ See Verdict Form, *Freeman v. Giuliani* (Dec. 15, 2023), ECF No. 135.

²² See Mem. and Order, *Freeman v. Giuliani* (Dec. 20, 2023), ECF No. 144.

²³ See Voluntary Pet., *In re Giuliani*, No. 23-12055 (Bankr. S.D.N.Y. Dec. 21, 2023), ECF No. 1, 2024 WL 3384185. Giuliani’s financial distress is not the end of his legal exposure: Giuliani is a criminal defendant in a sweeping racketeering case in Georgia, and his license to practice law has been revoked. Alanna Durkin Richer, *\$148 Million Damages Verdict Adds to Rudy Giuliani’s Financial Woes as He Awaits His Criminal Trial*, AP NEWS (Dec. 16, 2023, 4:52 PM), <https://perma.cc/3F97-2DXU>; Philip Marcelo, *Giuliani Is Disbarred in New York as Court Finds He Repeatedly Lied About Trump’s 2020 Election Loss*, AP NEWS (July 2, 2024, 7:48 PM), <https://perma.cc/45BP-XY6K>.

²⁴ See, e.g., Beau Evans, *Georgia Senate Panel Hosts Trump Attorney Giuliani as Election Officials Dispute Fraud Claims*, AUGUSTA CHRON. (Dec. 3, 2020, 7:04 PM), <https://perma.cc/T8ZS-4F8V>.

bankruptcy judge dismissed the case, ruling that Giuliani had not complied with the transparency required by a bankruptcy filing.²⁵ Since then, Giuliani's creditors' efforts to recover have continued in federal court, pursuant to nonbankruptcy rules.

Other examples of this phenomenon involve content producers who operate through alternative or social media.²⁶ Take Alex Jones, host of The Alex Jones Show and owner of InfoWars.com. Jones built an online empire, trafficking in far-right hysteria, dietary supplements, and conspiracy theories—including the notion that the 2012 Sandy Hook school shooting was a “false flag” operation.²⁷ Jones spread the conspiracy theory that no one had died at Sandy Hook, that the massacre was staged by gun control advocates, and that the parents were actors.²⁸ In response, grieving parents sued Jones in Texas²⁹ and Connecticut³⁰ for defamation and IIED.

²⁵ *In re Giuliani*, 2024 WL 3384185, at *4 (noting “Mr. Giuliani’s continued failure to meet his reporting obligations and provide the financial transparency required of a debtor in possession”).

²⁶ Numerous scholars have examined the impact of social media—with its Section 230 protection from liability—upon the traditional news press and the tradition of free speech. *See, e.g.*, Danielle Keats Citron & Mary Anne Franks, *The Internet as a Speech Machine and Other Myths Confounding Section 230 Reform*, 2020 U. CHI. LEGAL F. 45; Lyrissa Lidsky, *Defamation Law and the Crumbling Legitimacy of the Fourth Estate*, KNIGHT FIRST AMEND. INST. (July 11, 2024), <https://perma.cc/TK9X-TBB3>.

²⁷ Pls.’ Fourth Am. Pet., *Heslin v. Jones*, No. D-1-Gn-18-001835 2022, at ¶¶ 11–17 (Tex. Dist. Ct. Travis Cnty.), 2022 WL 4182077, at *2; *see also* Juan A. Lozano, *Who Is Alex Jones? The Conspiracist and Dietary Supplement Salesman Built an Empire Over Decades*, AP NEWS (June 14, 2024, 6:24 PM), <https://perma.cc/6QYN-ZAUE>. The truth is horrific: In 2012, a shooter entered Sandy Hook Elementary School in Newtown, Connecticut, and slaughtered twenty-six people, including twenty children. John Christoffersen & Jocelyn Noveck, *Routine Morning, Then Shots and Unthinkable Terror*, AP NEWS (Dec. 15, 2012, 1:18 AM), <https://perma.cc/5DE6-K9EJ>.

²⁸ *See* Pls.’ Fourth Am. Pet., *Heslin*, *supra* note 27, at ¶¶ 13–85, 2022 WL 4182077, at *2–10.

²⁹ The Texas litigation is comprised of three related actions: *Heslin v. Jones*, No. D-1-GN-18-001835 (Tex. Dist. Ct. Travis Cnty. 2018); *Lewis v. Jones*, No. D-1-GN-18-006623 (Tex. Dist. Ct. Travis Cnty. 2018); *Pozner v. Jones*, No. D-1-Gn-18-001842 (Tex. Dist. Ct. Travis Cnty. 2018).

³⁰ The Connecticut litigation is also comprised of three related actions, which were procedurally consolidated: *Compl., Lafferty v. Jones*, No. UWY-CV-18-6046436-S (Conn. Super. Ct. May 23, 2018), ECF No. 2; *Compl., Sherlach v. Jones*, No. UWY-CV-18-6046437-S (Conn. Super. Ct. July 2, 2018), ECF No. 2; *Compl., Sherlach v. Jones*, No. UWY-CV-18-60464386-S (Conn. Super. Ct. July 2, 2018), ECF No. 2.

Jones failed to comply with his discovery obligations, and so the judges entered default judgments against him and sent the cases to juries to determine damages.³¹ In 2022, a Texas jury awarded the parents \$49.3 million in damages,³² and a Connecticut jury awarded the parents \$1.5 billion in damages.³³ Jones filed for individual bankruptcy in Texas shortly afterward,³⁴ joining his company, Free Speech Systems, which had filed earlier that summer.³⁵ While Jones's personal estate is headed for liquidation, his corporate case ended up exiting bankruptcy court—after a judge found that it had lingered too long for the fast pace required of a small-business case under subchapter V of the Code.³⁶

³¹ Heslin v. Jones (*In re Jones*), 655 B.R. 868, 871–72 (Bankr. S.D. Tex. 2024) [hereinafter *In re Jones Personal Tex.*]; Wheeler v. Jones (*In re Jones*), No. 22-33553 (Bankr. S.D. Tex. 2023) [hereinafter *In re Jones Personal Conn.*], 2023 WL 6979358, at *1–2.

³² See, e.g., Roxanna Asgarian, *Texas Judge Rules Alex Jones Must Pay Sandy Hook Parents Full \$49 Million in Defamation Case*, TEX. TRIB. (Nov. 23, 2022, 11:00 AM), <https://perma.cc/J82G-UAS2>.

³³ See, e.g., Jack Queen & Jacqueline Thomsen, *Alex Jones Must Pay Sandy Hook Families Nearly \$1 Billion for Hoax Claims, Jury Says*, REUTERS (Oct. 12, 2022, 8:50 PM), <https://perma.cc/J5H9-75Q9>.

³⁴ See Voluntary Pet., *In re Jones Personal Tex.*, No. 22-33553 (Bankr. S.D. Tex. Dec. 2, 2022), ECF No. 1.

³⁵ See Voluntary Pet., *In re Free Speech Sys. LLC*, No. 22-60043 (Bankr. S.D. Tex. July 29, 2022), ECF No. 1. Jones's business elected to file under the new subchapter V of the Bankruptcy Code.

³⁶ See Order Dismissing Case, *id.*, ECF No. 956; see also Elizabeth Williamson, *Judge Orders Sale of Alex Jones's Personal Assets but Keeps Infowars in Business*, N.Y. TIMES (June 14, 2024). In the wake of that decision, the Texas and Connecticut creditors have continued to wrangle over the assets of Free Speech Systems. See Elizabeth Williamson, *Sandy Hook Families' Fight for Alex Jones's Money Takes an Ugly Turn*, N.Y. TIMES (June 27, 2024). As of last review before publication, the bankruptcy court halted the creditors' efforts so that Jones's chapter 7 trustee could conduct an orderly liquidation of Free Speech Systems and its assets. See, e.g., Dave Collins, *Bankruptcy Trustee Discloses Plan to Shut Down Alex Jones' Infowars and Liquidate Assets*, AP NEWS (June 24, 2024, 1:15 PM), <https://perma.cc/WWF6-TDME>. On November 14, 2024, the chapter 7 trustee announced that the winning bid was submitted by the Connecticut parents and Global Tetrahedron, LLC, the parent of the satirical news outlet *The Onion*, while the backup bid was submitted by First United American Companies, LLC. See Notice of Successful Bidder, *In re Jones Personal Tex.*, No. 22-33553 (Bankr. S.D. Tex. Nov. 14, 2024), ECF No. 903. The trustee's designation was immediately challenged.

Similarly, in April 2024, the parent company of *Gateway Pundit*, a right-wing blog founded by Missouri blogger Jim Hoft, filed for bankruptcy in Florida in the wake of defamation lawsuits

Turning from politics to entertainment, consider Tasha K (Latasha Transrina Kebe), a YouTuber with over one million subscribers to her account “unWine-withTashaK,” where she engages in salacious celebrity gossip. Tasha K spread lies about renowned rapper Cardi B (Belcalis Marlenis Almánzar), including the rumor that Cardi B had herpes and that her child had an intellectual disability because of the disease. In 2019, Cardi B sued Tasha K for defamation and won \$3.4 million in damages.³⁷ In 2023, Tasha K filed for bankruptcy in Florida, listing Cardi B as her largest creditor.³⁸

While one can imagine Giuliani’s case following a similar course before the dawn of the Internet, the cases of InfoWars and Tasha K seem more tightly tied to social media. These debtors built large online audiences, enabling them to gain enormous capacity for damage without a corresponding growth in personal or business wealth. In his bankruptcy petition, for example, Jones declared between

brought by Freeman and Moss. Voluntary Pet., *In re TGP Commc’ns, LLC*, No. 24-13938 (Bankr. S.D. Fla. Apr. 24, 2024), ECF No. 1; see Will Sommer, *Gateway Pundit to File for Bankruptcy Amid Election Conspiracy Lawsuits*, WASH. POST (Apr. 24, 2024, 4:33 PM). That case, too, was dismissed for the debtor’s failure to comply with its disclosure obligations. See *In re TGP Commc’ns, LLC*, No. 24-13938 (Bankr. S.D. Fla. Apr. 24, 2024), 2024 WL 3548248, at *4–6, 13. Several months after the dismissal, the litigants settled. See Jeff Amy, *Georgia Election Workers Settle Defamation Lawsuit Against Conservative Website*, AP NEWS (Oct. 11, 2024, 1:57 PM), <https://perma.cc/BLK4-VL7C>.

³⁷ Compl. and Demand for Jury Trial, *Almánzar v. Kebe*, No. 1:19-cv-01301-WMR (N.D. Ga. 2023), ECF No.1; Compl. to Determine Non-Dischargeability of Debt, *Almánzar v. Kebe* (*In re Kebe*), No. 23-01153-SMG, at ¶¶ 16–31 (Bankr. S.D. Fla. Aug. 8, 2023).

³⁸ Voluntary Pet. Sch. E/F, *In re Kebe*, No. 23-14082-SMG (Bankr. S.D. Fla. May 25, 2023), ECF No. 1 (listing claims).

\$1 and \$10 million in assets³⁹ (an assertion that one should take with some skepticism⁴⁰), compared to \$1 to \$10 billion in liabilities.⁴¹ Tasha K declared between \$50,000 and \$100,000 in assets, compared to \$1 to \$10 million in debt.⁴²

The #MeToo Movement has also produced a number of defamation-to-bankruptcy cases. In 2017, prompted by news reports of sexual harassment allegations against Hollywood film mogul Harvey Weinstein,⁴³ women across the world took to social media to share stories of sexual harassment, rape, and hostile work environments under the hashtag #MeToo.⁴⁴ Many women shared their stories for the first time; others found that previously ignored or minimized accounts gained new weight as they retold their stories alongside thousands of others, underscoring the severity and pervasiveness of sexual harassment in American culture. Since many of the allegations were years or decades old, statutes of limitations barred claims for rape and sexual harassment.⁴⁵

Defamation law became a second-best avenue for litigating sexual harassment. Some men sued their accusers for defamation; other men denied the accusations publicly and, in turn, were sued for their denials.⁴⁶ In 2023, for example, former

³⁹ See Voluntary Pet., *In re Jones Personal Tex.*, *supra* note 31, at 7.

⁴⁰ The plaintiffs accused Jones of transferring assets to his wife and parents, and of fraudulently entering into secured transactions. The Sandy Hook parents sued to unwind those transactions in 2022. See Heslin, 2022 WL 4182077, at *2; see also Elizabeth Williamson & Emily Steel, *Sandy Hook Families Are Fighting Alex Jones and the Bankruptcy System Itself*, N.Y. TIMES (Mar. 18, 2023), <https://perma.cc/8ZTA-BRU6>.

⁴¹ Voluntary Pet., *In re Jones Personal Tex.*, *supra* note 31, at 7. Jones also filed his media company Free Speech Systems for chapter 11 bankruptcy. See *In re Free Speech Systems, LLC*, *supra* note 35.

⁴² Voluntary Pet., *In re Kebe*, *supra* note 37, at ¶ 20.

⁴³ See Ronan Farrow, *From Aggressive Overtures to Sexual Assault: Harvey Weinstein's Accusers Tell Their Stories*, NEW YORKER (Oct. 10, 2017, 10:47 AM), <https://perma.cc/LC7G-N9F5>; Harvey Weinstein Timeline: How the Scandal Has Unfolded, BBC (Feb. 24, 2023), <https://perma.cc/Q2CP-SY2U>.

⁴⁴ See Leah Asmelash, *In 5 Years of #Metoo, Here's What's Changed – and What Hasn't*, CNN (Oct. 27, 2022, 11:17 AM), <https://perma.cc/E5VV-AH9C>.

⁴⁵ Julia Jacobs, *#MeToo Cases' New Legal Battleground: Defamation Lawsuits*, N.Y. TIMES (Jan. 12, 2020), <https://perma.cc/B8WY-PLAC>.

⁴⁶ Whether defamation law ultimately subverts or reinforces gender norms is up for some debate and may change over time. In 1997, Professor Diane Borden conducted a study of defamation

FTC Commissioner and ex-George Mason University law professor Joshua Wright filed a \$108 million defamation claim against two attorneys who told Law360 that he had sexually harassed them while they were 1Ls.⁴⁷ Conversely, in 2018, actor Ashley Judd sued Harvey Weinstein for defamation after learning that Weinstein had claimed she was a “nightmare to work with.”⁴⁸

Of course, Weinstein went to prison, not into bankruptcy,⁴⁹ though his network of film production companies filed for bankruptcy in Delaware in 2018.⁵⁰

As with Weinstein, not all defamation cases end up in bankruptcy. In some cases, even very large defamation judgments do not create financial distress in a wealthy debtor. In other cases, substantial defamation judgments spark speculation about financial distress, but we have not yet seen a bankruptcy filing. This category

actions and concluded that women were more successful when they alleged harm to their “private-sphere roles” rather than their “public-sphere roles.” Diane L. Borden, *Patterns of Harm: An Analysis of Gender and Defamation*, 2 COMM’N L. & POL’Y 105, 107 (1997). One wonders whether the result would hold for the #MeToo defamation cases.

⁴⁷ See Compl., Wright v. Dorsey, No. CL-2023-12232 (Va. Cir. Ct. Fairfax Cnty. Aug. 24, 2023), ECF No. 1; Aebera Coe, *‘I Suffered Silently’: Ex-Law Prof Allegedly Preyed on Students*, LAW360 (Aug. 14, 2023, 12:11 PM), <https://perma.cc/4TD9-8WUW>. Dorsey and Landry filed a counterclaim alleging a violation of Virginia’s Anti-SLAPP law, Wright filed an amended complaint adding his company, Lodestar Law & Economics, and the matter is set for trial in early 2025. Dorsey & Landry’s Countercl., Wright, No. CL-2023-12232.

⁴⁸ Judd v. Weinstein, 967 F.3d 952, 954 (9th Cir. 2020); see First Am. Compl., Judd v. Weinstein, No. 2:18CV05724 (C.D. Cal. 2018), ECF No. 26.

⁴⁹ People v. Weinstein, No. 24 (N.Y. Apr. 25, 2024), 2024 WL 1773181, at *1. Weinstein was found guilty in both Los Angeles and New York, though his conviction in the latter state has recently been overturned by the New York Court of Appeals, which ruled in April 2024 that evidence of Weinstein’s prior bad acts was improperly admitted at trial. See *id.* at *12–13. He was subsequently indicted again. See Adam Reiss, Chloe Melas & Daniel Arkin, *Harvey Weinstein Indicted on New Charges by New York Grand Jury*, NBC NEWS (Sept. 12, 2024, 10:23 AM), <https://perma.cc/BGS9-GVC7>.

⁵⁰ Order Directing Joint Administration of the Debtors’ Chapter 11 Cases, *In re The Weinstein Company Holdings LLC, et al.*, No. 18-10601-MFW (Bankr. D. Del. Mar. 20, 2018), ECF No. 69.

may include actor Amber Heard,⁵¹ politician Donald Trump,⁵² and comedian Bill Cosby.⁵³ As we will see below,⁵⁴ bankruptcy does not solve all financial problems and it comes with heavy costs, so debtors tend to forego a filing if at all possible.

B. Tectonic Shifts in the Law

We have a second reason to expect more defamation activity in the coming years: tectonic shifts in the legal framework, either at the federal or the state level.

1. The Supremes Wobble

The Supreme Court has taught since the 1960s that the First Amendment requires a heightened showing for defamation actions. But a handful of recent cases

⁵¹ In 2022, a jury found Amber Heard liable to Johnny Depp for \$15 million, including \$10 million in compensatory damages and \$5 million in punitive damages. Judgment Order, *Depp v. Heard*, No. CL-2019-2911 (Va. Cir. Ct. 2022), 2022 WL 2342058, at *1–2. Commentators have wondered about Heard’s financial health, but an insurance dispute appears to be the first order of business. See, e.g., Second Am. Compl., *New York Marine & Gen. Ins. Co. v. Heard*, No. 2:22-cv-04685 (C.D. Cal. Aug. 28, 2023), ECF No. 76, 2023 WL 5723286; Aaron Keller, *Amber Heard Would ‘Gain No Real Benefit’ by Using Bankruptcy to Avoid Paying Johnny Depp Millions, but There’s a Catch: Law Prof*, LAW & CRIME (June 2, 2022, 2:56 PM), <https://perma.cc/LE2J-2K63>.

⁵² In 2019, the author E. Jean Carroll accused Donald Trump of sexually assaulting her. When Trump denied the accusation, saying Carroll was “totally lying” and “not my type,” she sued him for defamation. See, e.g., Compl. & Demand for Jury Trial, *Carroll v. Trump*, No. 22-cv-10016-UA, at ¶¶ 99–107 (S.D.N.Y. Nov. 24, 2022), ECF No. 1, 2022 WL 19826795, at *11–12. In May 2023, a New York jury found Trump liable for \$5 million. Verdict Form, *id.* Trump continued to defame Carroll, and she sued him again: He now owes \$83.3 million, rulings he has appealed. See Jake Offenhardt, *Trump’s Legal Debts Top a Half-Billion Dollars. Will He Have to Pay?*, L.A. TIMES (Feb. 17, 2024, 11:16 AM), <https://perma.cc/GDK9-6C8R>. Those sizable judgments, along with additional debt from Trump’s civil fraud case, have prompted speculation about Trump’s financial health. See, e.g., Maggie Haberman, *Trump’s Financial Squeeze*, N.Y. TIMES (Mar. 26, 2024). That said, Donald Trump’s decisive victory in the 2024 presidential election makes the odds of a bankruptcy filing vanishingly small—at least until his second (and final) term ends in January 2029.

⁵³ Bill Cosby has been fending off numerous defamation lawsuits in recent years. See, e.g., Second Am. Compl., *Green v. Cosby*, No. 3:14-cv-30211-MGM (D. Mass. Apr. 16, 2015), ECF No. 48, 2015 WL 1850657; Barbara Goldberg, *Bill Cosby Settles Defamation Lawsuit Brought by Seven Women*, REUTERS (Apr. 5, 2019, 10:01 PM), <https://perma.cc/K7Y7-GHU6>. Even though he has settled some of the claims, commentators have wondered about his ability to pay all of them. Whitney Vasquez, *Bill Cosby in ‘Financial Turmoil,’ Liquidating Assets and ‘Selling Off Artwork’ to Fight Civil Lawsuits*, RADAR ONLINE (Nov. 13, 2023, 2:30 PM), <https://perma.cc/Y26Z-Q9UW>.

⁵⁴ See *infra* Section II.A

indicate that some of the Justices would like to reconsider the scope of that protection.

In *New York Times v. Sullivan*,⁵⁵ *Gertz v. Robert Welch*,⁵⁶ and subsequent cases, the Supreme Court held that the First Amendment requires a defamation plaintiff to prove “actual malice” when (a) the plaintiff is a public figure and the defamatory statements involve issues of public concern;⁵⁷ or (b) the plaintiff seeks presumed or punitive damages, regardless of whether the plaintiff is a public figure or not.⁵⁸ Underscoring the importance of free speech in our democracy, the Supreme Court pointed out that public figures can readily mount a defense in the public square, instead of relying on the courts.⁵⁹ Since those seminal cases, courts have expanded

⁵⁵ 376 U.S. 254 (1964).

⁵⁶ 418 U.S. 323 (1974).

⁵⁷ See *Sullivan*, 376 U.S. at 279–80 (requiring public officials to prove “actual malice” to recover damages in a defamation case); *Dun & Bradstreet, Inc. v. Greenmoss Builders, Inc.*, 472 U.S. 749, 757–61 (1985). “Actual malice” is met if the speaker knew the statement was false or made it with “reckless disregard of whether it was false or not.” *Sullivan*, 376 U.S. at 280. The Court then expanded the requirement to public figures. See *Curtis Publ’g Co. v. Butts*, 388 U.S. 130, 153–56 (1967) (expanding the *New York Times* protections to public figures, including two football coaches and a former U.S. army general); *Associated Press v. Walker*, 389 U.S. 28 (1967). *Gertz* refined the *Curtis Publishing* rule several years later, separating all-purpose public figures and limited-purpose public figures. *Gertz*, 418 U.S. at 344–46. Limited-purpose public figures “thrust themselves to the forefront of particular public controversies in order to influence the resolution of the issues involved.” *Id.* at 345. *Gertz* clarifies that such public figures typically expose themselves to increased risk of “defamatory falsehood” and have “a more compelling call on the courts for redress of injury inflicted.” *Id.* All-purpose public figures, by contrast, have compelling persuasive power and could be seen as more traditional public officials. See *id.*

⁵⁸ *Id.* at 344–46 (“Private individuals are therefore more vulnerable to injury, and the state interest in protecting them is correspondingly greater. . . . Thus, private individuals are not only more vulnerable to injury than public officials and public figures; they are also more deserving of recovery.”). “We hold that, so long as they do not impose liability without fault, the States may define for themselves the appropriate standard of liability for a publisher or broadcaster of defamatory falsehood injurious to a private individual.” *Id.* at 347.

⁵⁹ See *id.* at 344 (“Public officials and public figures usually enjoy significantly greater access to the channels of effective communication and hence have a more realistic opportunity to counteract false statements than private individuals normally enjoy.”).

the scope of this heightened requirement to include individuals who find themselves thrust into the limelight, such as by “going viral” on social media.⁶⁰

Two Justices have recently signaled their discomfort with *New York Times* and its progeny and have expressed a willingness to reconsider the doctrine. In *McKee v. Cosby*,⁶¹ Kathrine McKee asked the Supreme Court to take up her defamation claim against Bill Cosby. In 2014, McKee had publicly accused Cosby of raping her forty years earlier; Cosby’s response letter was leaked and disseminated around the world. McKee then sued Cosby for defamation.⁶² The district court dismissed the suit, deeming McKee to be a public figure,⁶³ and the First Circuit affirmed.⁶⁴ Although the Supreme Court decided not to review the dismissal, Justice Thomas wrote a lengthy concurrence, arguing that *New York Times* and its progeny were “policy-driven decisions masquerading as constitutional law” and urging the Court to reconsider its jurisprudence.⁶⁵

Then, in *Berisha v. Lawson*,⁶⁶ Shkelzen Berisha asked the Supreme Court to take up his defamation claim against Guy Lawson. In 2015, Lawson published a book

⁶⁰ Lower courts have had to further refine the distinctions made by the Supreme Court. The Ninth Circuit, for example, asks:

- (i) whether a public controversy existed when the statements were made,
- (ii) whether the alleged defamation is related to the plaintiff’s participation in the controversy, and
- (iii) whether the plaintiff voluntarily injected itself into the controversy for the purpose of influencing the controversy’s ultimate resolution.

See *Makaeff v. Trump Univ., LLC*, 715 F.3d 254, 266 (9th Cir. 2013). The Ninth Circuit utilized this test twice to find limited-public figure status for entities that engaged social media for advertising efforts or to “invite[] public attention.” *Id.* at 268–69 (internal citation omitted); see also *Planet Aid, Inc. v. Reveal*, 44 F.4th 918, 924–25 (9th Cir. 2022).

⁶¹ 139 S. Ct. 675 (2019) (denying cert.).

⁶² *McKee v. Cosby*, 874 F.3d 54, 54 (1st Cir. 2017).

⁶³ *McKee v. Cosby*, 236 F. Supp. 3d 427, 445–47 (D. Mass. 2017).

⁶⁴ *McKee*, 874 F.3d at 61–65.

⁶⁵ *McKee*, 139 S. Ct. at 676 (Thomas, J., concurring from denial of cert.); see also *Coral Ridge Ministries Media, Inc. v. S. Poverty L. Ctr.*, 142 S. Ct. 2453 (2022) (Thomas, J., dissenting from denial of cert.) (arguing for reconsideration of *Sullivan*).

⁶⁶ 141 S. Ct. 2424 (2021) (denying cert.).

accusing Berisha (the son of the former prime minister of Albania) of being associated with the Albanian mafia.⁶⁷ The book was turned into a Warner Brothers movie called *War Dogs*.⁶⁸ Berisha sued for defamation. The district court granted summary judgment for the defendant on the grounds that Berisha was a public figure,⁶⁹ and the Eleventh Circuit affirmed.⁷⁰ As in *McKee*, the Supreme Court declined to take the case, but now both Justice Thomas and Justice Gorsuch dissented. Thomas expressed skepticism that the First Amendment would require public figures to forego civil remedies,⁷¹ especially when the plaintiff never “voluntarily sought attention.”⁷² Gorsuch, dissenting separately, emphasized that the scope of First Amendment protection needed to be reconsidered for a new media environment.⁷³

Scholars like John Bruce Lewis, Bruce L. Ottley, Lyrissa Lidsky, RonNell Andersen Jones, and others have begun to debate the pros and cons of defamation reform.⁷⁴ Naturally, if the Supreme Court pulls back on the scope of First Amendment protection for defamation defendants,⁷⁵ we would see more civil exposure—and, correspondingly, more defamation debt in bankruptcy.

⁶⁷ *Berisha v. Lawson*, 973 F.3d 1304, 1306–09 (11th Cir. 2020).

⁶⁸ *WAR DOGS* (Warner Bros. 2016); see *Berisha*, 973 F.3d at 1309.

⁶⁹ See *Berisha v. Lawson*, 378 F. Supp. 3d 1145, 1155–60, 1163–64 (S.D. Fla. 2018).

⁷⁰ *Berisha*, 973 F.3d at 1321.

⁷¹ *Berisha*, 141 S. Ct. at 2425 (Thomas, J., dissenting from denial of cert.).

⁷² *Id.* (quoting *Berisha*, 378 F. Supp. 3d 1145, 1156 (S.D. Fla. 2018)).

⁷³ *Berisha*, 141 S. Ct. at 2425, 2425–30 (Gorsuch, J., dissenting from denial of cert.).

⁷⁴ See, e.g., John Bruce Lewis & Bruce L. Ottley, *New York Times v. Sullivan at 60: Where Does Defamation Law Go Now?*, 73 DEPAUL L. REV. 995, 1066 (2024) (arguing for expedited procedures under anti-SLAPP laws); Lyrissa Lidsky, *Cheap Speech and the Gordian Knot of Defamation Reform*, 3 J. FREE SPEECH L. 79, 80 (2023) (advocating for a “comprehensive approach to reform”); RonNell Andersen Jones, *Defamation, Disinformation, and the Press Function*, 3 J. FREE SPEECH L. 103, 104 (2023) (arguing that a “*Sullivan* scaleback” would harm news entities that already have the right incentives to produce accurate reporting).

⁷⁵ It is hard to know whether the Supreme Court’s wobble has petered out. In *Frese v. Formella*, 53 F.4th 1 (1st Cir. 2022), petitioners sought the High Court’s review of a New Hampshire criminal defamation law. One of only a few states with a criminal defamation statute, New Hampshire makes it a misdemeanor to purposely share “any information which [the defendant] knows to be false and knows will tend to expose any other living person to public hatred, contempt, or ridicule.” N.H. REV. STAT. § 644:11(1); see *Frese*, 53 F.4th at 1. The First Circuit upheld the law, noting that its limited scope fell within what the Supreme Court had previously deemed permissible. *Frese*, 53 F.4th at

2. State Legislative Initiatives

In any event, the signals from Thomas and Gorsuch have emboldened some state legislators, who have proposed laws that would dramatically expand defamation liability and invite First Amendment challenges that could press the Supreme Court for new decisions.

In 2023, for example, Florida lawmakers considered House Bill 991, which would have provoked several constitutional challenges. First, the bill would have specified that those who merely defend themselves or “go viral” on social media are not “public figures,”⁷⁶ a clarification that conflicts with several cases decided by lower courts under the U.S. Constitution. Second, the bill would have defined any accusations of discrimination on account of race, sex, sexual orientation, or gender identity to be defamation per se, and would award successful plaintiffs statutory damages of \$35,000 in addition to other damages.⁷⁷ In such cases, defendants could not prove the truth of their statements by referring to a plaintiff’s religious or scientific beliefs.⁷⁸ The bill also would have enacted fee-shifting for successful plaintiffs.⁷⁹

We should not overestimate the likely success of such efforts. H.B. 991 died in committee. Still, it may spark subsequent legislation in Florida or other states.⁸⁰

6 (quoting *Garrison v. Louisiana*, 379 U.S. 64, 75 (1964)). Even though criminal punishment of defamation raises even more serious First Amendment concerns than civil liability, the Court denied certiorari in 2023, with no dissenters. *Frese v. Formella*, 144 S. Ct. 72 (2023) (mem. op.) (denying cert.). In *Counterman v. Colorado*, 143 S. Ct. 2106 (2023), six Justices drew on *Sullivan* to inform what type of *mens rea* the First Amendment requires before punishing threats. *Id.* at 2115, 2130. And in *Blankenship v. NBCUniversal*, 144 S. Ct. 5 (2023), the Court denied a petition for certiorari that asked it to overrule *Sullivan*.

⁷⁶ H.R. 991, 125th Leg. (Fla. 2023) (amending FLA. STAT. § 770.105).

⁷⁷ *Id.* (amending FLA. STAT. § 771.11).

⁷⁸ *Id.*

⁷⁹ *Id.* (amending FLA. STAT. § 770.09).

⁸⁰ In 2024, the Florida Legislature considered a successor bill, H.B. 757, which does not contain many of the most objectionable provisions, but it would create a presumption of actual malice when a publisher relies solely on an anonymous source for a defamatory claim. *See* H.R. 757, 125th Leg. (Fla. 2024) (establishing FLA. STAT. 770.11); *see also* S.B. 1780, 125th Leg. (Fla. 2024) (same). Those bills have since died as well.

C. Defamation Debt in Bankruptcy

All told, it may be too early to measure the defamation-to-bankruptcy pipeline with precision. And, of course, it is not entirely new. Consider murder suspect Casey Anthony. In 2008, a meter reader stepped into the woods behind an Orlando home and found the skeletal remains of a child, stuffed in a laundry bag, with duct tape covering the mouth of the child's skull.⁸¹ Florida authorities identified the skeleton as belonging to missing toddler Caylee Anthony.⁸² State prosecutors charged her mother, Casey Anthony, with first-degree murder.⁸³ The jury found Anthony not guilty of the most serious charges—a result that shocked the American public.⁸⁴

What fewer news outlets focused on, though, was the bankruptcy aftermath. Anthony's legal team had pointed the finger at the meter reader, Roy Kronk, as well as Caylee's babysitter, Zenaida Gonzalez, implying that one of them had murdered Caylee. Both Kronk and Gonzalez sued Anthony for defamation.⁸⁵ Faced with mounting civil legal exposure, Anthony filed for bankruptcy in 2013.⁸⁶

There is, as the Teacher said, nothing new under the sun.⁸⁷ Still, we should anticipate more cases in the defamation-to-bankruptcy pipeline for three reasons. First, as discussed above, the sheer size of defamation judgments is growing, making it more likely that a defamation verdict (or even the threat of one) could swamp a defendant. Second, the growth in legal exposure is financially asymmetric; it does

⁸¹ Natisha Lance & John Couwels, *Caylee Anthony's Skull Was Duct-Taped*, CNN (June 19, 2009), <https://perma.cc/R9BQ-HWBK>.

⁸² *Id.*

⁸³ Breeanna Hare, 'What Really Happened?': The Casey Anthony Case 10 Years Later, CNN (June 30, 2018, 12:54 AM), <https://perma.cc/FLT9-R2ML>.

⁸⁴ *Id.*

⁸⁵ Kronk v. Anthony (*In re Anthony*), No. 8:13-bk-00922-RCT (Bankr. M.D. Fla. Feb. 28, 2019), 2019 WL 10734097, at *1; Gonzalez v. Anthony (*In re Anthony*), 538 B.R. 145, 147–50 (Bankr. M.D. Fla. 2015).

⁸⁶ See Voluntary Pet., *In re Anthony*, No. 8:13-bk-00922-KRM (Bankr. M.D. Fla. Jan. 25, 2013), ECF No. 1; see also Associated Press, *Casey Anthony Files for Bankruptcy in Orlando*, FLA. TIMES-UNION (Jan. 28, 2013, 4:12 AM), <https://perma.cc/EPZ6-ZN99>. Both defamation claims ended up being dischargeable. See *infra* note 126 and accompanying text.

⁸⁷ *Ecclesiastes* 1:9.

not come with a corresponding growth in assets.⁸⁸ Indeed, the social media ecosystem makes it easier for a regular person, not a media tycoon nor even a workaday journalist indemnified by their employer, to “go viral” and cause harm far beyond their means. And third, legal reform efforts would increase the very types of liability that can be discharged in bankruptcy.

If a new generation of defamation defendants is tagged with significant statutory or negligence damages, a bankruptcy case could grant them a fresh start, incentivizing more bankruptcy filings. But bankruptcy does not wipe away claims for “willful and malicious” injury—and, as we’ll see below,⁸⁹ that fact dramatically impacts bankruptcy’s efficacy for some defamation defendants.

II. BANKRUPTCY-PROOF JUDGMENTS

Defamation defendants who file for bankruptcy soon realize that bankruptcy is not a magic wand.⁹⁰ True, the filing of a petition in bankruptcy imposes an automatic stay that pauses debt collection activity,⁹¹ and bankruptcy can resolve some financial problems, but the pathway to debt forgiveness is narrow and costly. Bankruptcy for individuals can last anywhere from ninety days to several years, and it includes routine financial disclosures and examinations that put the debtor in a “fishbowl” for the duration of the case.⁹² And while bankruptcy promises an orderly resolution of debt, a filing also requires the debtor to notify all creditors of the case, drawing everyone to bankruptcy court and putting an end to one-at-a-time negotiations.⁹³ Navigating the bankruptcy process almost always requires an attorney (and attendant attorneys’ fees). Even a successful bankruptcy case leaves a stain on an individual’s credit score for ten years,⁹⁴ and a debtor cannot file a subsequent

⁸⁸ As Prof. Gus Hurwitz puts it, “[t]he cost of producing and publishing speech has never been lower and the scale of the audience for that speech has never been larger.” Justin “Gus” Hurwitz, *Defamation and Privacy: What You Can’t Say About Me*, 3 J. FREE SPEECH L. 75, 75 (2023).

⁸⁹ See *infra* Part II.

⁹⁰ See Nani, *supra* note 15.

⁹¹ See 11 U.S.C. § 362.

⁹² See, e.g., 11 U.S.C. § 343 (requiring the debtor to “appear and submit to examination under oath at the meeting of creditors); *id.* § 521 (listing debtor’s duties, including numerous disclosure obligations).

⁹³ See, e.g., FED. R. BANKR. P. 2002 (providing for notices to creditors).

⁹⁴ 15 U.S.C. § 1681c(a)(1) (providing that a credit report may not include a record of a bankruptcy case that antedates the report by more than ten years).

bankruptcy case without waiting a significant period of time.⁹⁵ The same factors cut against the frivolous use of bankruptcy for businesses.⁹⁶

At the same time, the bankruptcy “discharge” (a permanent injunction against the collection of a debt) can ameliorate many kinds of financial problems. Indeed, because of bankruptcy’s expansive definition of “claim,” debtors can gather up and resolve any debts that have arisen before the petition date, including claims that haven’t yet seen the inside of a courtroom.⁹⁷

But the discharge comes with limits. For example, debtors who have concealed or destroyed assets or records, made false claims, or refused to testify are ineligible for the discharge.⁹⁸ Crucially, while the discharge covers a wide world of prepetition debts—that is, debts arising before the filing of the bankruptcy petition—it does not cover postpetition debts.⁹⁹ And, most importantly for individual defamation defendants, the discharge comes with numerous exceptions, one of which—debts for “willful and malicious injury”—may apply to certain kinds of defamation debt.

This Part analyzes how the discharge exceptions apply in defamation cases and shows how a bankruptcy filing is not the panacea that many imagine it to be. Indeed, by the time a defendant becomes a debtor, the dischargeability of defamation debt may have been settled already.

A. *Willful and Malicious Injury*

Section 523 of the Bankruptcy Code contains a list of twenty exceptions to the bankruptcy discharge, or “nondischargeable” debt. The discharge exceptions include certain debts owed to the government, such as taxes, fines, and, for some debtors, student loans;¹⁰⁰ domestic support obligations and debts incurred in the

⁹⁵ 11 U.S.C. § 727.

⁹⁶ The length of the cooldown period turns upon the type of the prior bankruptcy and the subsequent bankruptcy. *See* 11 U.S.C. § 727(a)(8)–(9) (providing that chapter 7 debtors cannot receive a discharge if they received a chapter 11 discharge within eight years or a chapter 12 or 13 discharge within six years); *id.* § 1328(f) (providing that chapter 13 debtors cannot receive a discharge if they received a chapter 7, 11, or 12 discharge within four years, or a chapter 13 discharge within two years).

⁹⁷ *Id.* § 524(a)(2).

⁹⁸ *Id.* § 727.

⁹⁹ *See id.* §§ 727(b), 1141(d)(1)(A).

¹⁰⁰ 11 U.S.C. § 523(a)(1), (7), (8), (14). Federal judgments for restitution are likewise excepted from the discharge. *Id.* § 523(a)(13).

course of divorce or separation;¹⁰¹ and debts for various bad acts, like money obtained through fraud or false pretenses,¹⁰² defalcation, embezzlement, or larceny;¹⁰³ drunk driving,¹⁰⁴ securities law violations,¹⁰⁵ slavery or sex trafficking,¹⁰⁶ and—core to our topic—debts for “willful and malicious injury.”¹⁰⁷

The phrase “willful and malicious” presents thorny statutory interpretation questions, with no obvious tiebreaker. Courts sometimes invoke bankruptcy’s “fresh start” policy to construe the discharge exceptions narrowly in favor of the debtor (like the rule of lenity),¹⁰⁸ but that canon of construction applies more naturally to debtors who fell behind on student loans or their taxes than to a debtor who is liable for “willful and malicious” injury. As the Supreme Court has pointed out, the “fresh start” is for the “honest but unfortunate debtor,”¹⁰⁹ so to apply the canon when trying to figure out if the debtor caused “willful and malicious” injury would be textbook question-begging.

Plus, purposivism is on shaky doctrinal footing these days. In 2023, the Supreme Court in *Bartenwerfer v. Buckley*¹¹⁰ applied a textualist approach to section 523(a), holding that the passive phrase “obtained by fraud” was not limited to the debtor’s fraud, but could mean debt that was “obtained” by someone else’s fraud, so long as the debtor was still liable for the debt under state law.¹¹¹ Writing for a

¹⁰¹ *Id.* § 523(a)(5), (15).

¹⁰² *Id.* § 523(a)(2). The Supreme Court took up a case under this subsection in *Bartenwerfer*. See *infra* notes 111–114 and accompanying text.

¹⁰³ *Id.* § 523(a)(4).

¹⁰⁴ *Id.* § 523(a)(9).

¹⁰⁵ *Id.* § 523(a)(19).

¹⁰⁶ *Id.* § 523(a)(20).

¹⁰⁷ *Id.* § 523(a)(6).

¹⁰⁸ See, e.g., *Denton v. Hyman (In re Hyman)*, 502 F.3d 61, 66 (2d Cir. 2007) (“The consequences to a debtor whose obligations are not discharged are considerable; in many instances, failure to achieve discharge can amount to a financial death sentence. In view of these harsh consequences, exceptions to discharge are to be narrowly construed, and genuine doubts should be resolved in favor of the debtor.”).

¹⁰⁹ See, e.g., *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (citing *Williams v. U.S. Fidelity & Guaranty Co.*, 236 U.S. 549, 554–55 (1915)).

¹¹⁰ 143 S. Ct. 665 (2023).

¹¹¹ *Id.* at 670.

unanimous Court, Justice Barrett underscored the Code's use of the passive voice¹¹² and poo-pooed bankruptcy policy as a "last-ditch effort" to persuade the Court with "color."¹¹³ The problem with purposivism, noted the Court, is that Congress never pursues any policy "at all costs," so the Bankruptcy Code reflects a balance.¹¹⁴ Implicitly stated, of course, is the premise that fidelity to that balance is best undertaken by interpreting the text without resort to policy arguments.

So what does "willful and malicious" mean? Numerous courts have held that breach of contract does not result in the sort of "injury" meant by the Code¹¹⁵—this is the domain of torts. Although one might suppose that the phrase "willful and malicious" would capture something of common-law "malice" (hatred, ill-will, or spite), most bankruptcy courts interpret "willful and malicious" to require a conjunctive, two-part analysis: A claim is nondischargeable only when the debtor (a) intended to cause harm (b) without legal justification.¹¹⁶ As to the requisite culpability standard, negligent or reckless action does not suffice, and even intentional action counts only where the debtor intended injury or acted with substantial certainty that injury would result.¹¹⁷ A creditor seeking to prove nondischargeability of a debt must do so by preponderance of the evidence.¹¹⁸

For example, Michael Hanson had HPV with an active outbreak of warts. He had unprotected sex with his girlfriend, Teresa Fischer, and did not warn her of his disease, even though he knew that it was sexually transmitted. Five months after they moved in together, Fischer had an abnormal pap smear, but Hanson still did not disclose his condition. Fischer sued Hanson in Montana state court. When

¹¹² *Id.*; see also Laura N. Coordes, *'Til Fraud Do Us Part: Bartenwerfer v. Buckley*, 26 GREEN BAG 273 (2023) (underscoring the hypertextual focus of the *Bartenwerfer* Court).

¹¹³ *Bartenwerfer v. Buckley*, 598 U.S. 69, 80–81 (2023).

¹¹⁴ *Id.* at 81–83.

¹¹⁵ See 4 COLLIER ON BANKRUPTCY ¶ 523.12 n.4 (16th ed. 2024) (collecting cases).

¹¹⁶ *Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998); see also 4 COLLIER ON BANKRUPTCY ¶ 523.12 (16th ed. 2024); *MarketGraphics Rsch. Grp., Inc. v. Berge (In re Berge)*, 953 F.3d 907, 914 (6th Cir. 2020).

¹¹⁷ See *Kawaauhau*, 523 U.S. at 61–62.

¹¹⁸ *Grogan v. Garner*, 498 U.S. 279, 286 (1991). Bankruptcy courts make such determinations as part of an "adversary proceeding" in bankruptcy, essentially a separate civil action, associated with the bankruptcy case, that includes dispositive motions, discovery, a trial before the judge as factfinder, and appellate rights. See FED. R. BANKR. P. 4007.

Hanson filed for bankruptcy, Fischer argued that Hanson's debt to her was nondischargeable as a "willful and malicious injury," and the bankruptcy court agreed.¹¹⁹

Debts for intentional torts generally fall within the discharge exception. Most courts, for example, have interpreted sexual harassment claims to fall within the discharge exception, though others insist on additional evidence of intent.¹²⁰

But other torts, where a defendant can be found liable for negligence or recklessness, present a tougher analysis. Even if the elements of the underlying claim do not require willful or malicious conduct, bankruptcy courts examine the factual record to see if the debtor's conduct fits the language of the discharge exception. In *McClendon v. Springfield*,¹²¹ for example, a jury found the debtor liable for \$341,000 in actual damages for defamation.¹²² Even though the state court judgment did not require "willful or malicious" conduct, the bankruptcy court conducted additional factfinding, disbelieved the debtor's testimony that he believed his statements were true, and deemed the debt nondischargeable.¹²³ Other courts have followed the same approach.¹²⁴

¹¹⁹ Fischer v. Hanson (*In re Hanson*), 171 B.R. 869, 872–74 (Bankr. D. Minn. 1994).

¹²⁰ See Gross, *supra* note 9, at 483 n.9 (analyzing cases). As Gross uncovers, in one case, the bankruptcy court required another trial to show intent, but the victim refused to re-testify. See Sanger v. Busch (*In re Busch*), 311 B.R. 657, 669 (Bankr. N.D.N.Y. 2004). The court found the debt dischargeable, a result that has been sharply criticized. See David L. Adamson, *The Discharge of Sexual Harassment Judgments in Bankruptcy Court: An Attempt to Right a "Grave Injustice,"* 25 HOFSTRA LAB. & EMP. L.J. 283, 285–95 (2007); Andy Gaunce, *Rethinking In re Busch: Bankruptcy Discharge of Sexual Harassment Judgments Under Section 523(a)(6)*, 56 S.C. L. REV. 645, 645–46 (2005).

¹²¹ *In re McClendon*, 765 F.3d 501 (5th Cir. 2014).

¹²² *Id.* at 503–04.

¹²³ *Id.* at 504–05 (noting that the bankruptcy court "conducted an independent inquiry into the willful and malicious character of McClendon's defamatory statements, conducting a trial of its own into questions not determined by the state court jury"). The Fifth Circuit affirmed on a clear error standard of review. *Id.* at 504, 506.

¹²⁴ See, e.g., Conte v. Gautam (*In re Conte*), 33 F.3d 303, 305 (3d Cir. 1994) (reversing bankruptcy court on issue preclusion and remanding for factfinding); MarketGraphics Rsch. Grp., Inc. v. Berge (*In re Berge*), 953 F.3d 907, 912–13 (6th Cir. 2020) (affirming bankruptcy court that denied preclusive effect to a state court judgment and held a bench trial on the issue of malice); First Weber Grp., Inc. v. Horsfall, 738 F.3d 767, 775 (7th Cir. 2013) (affirming bankruptcy court's preclusion determination in part and finding no clear error in bankruptcy court's trial).

Similarly, courts typically find that vicarious liability, by itself, cannot establish the necessary intent for nondischargeability.¹²⁵ But they will hear additional facts that might show the requisite intent. This approach played out in Casey Anthony's bankruptcy case. The bankruptcy judge found that Anthony's legal team was only attempting to create reasonable doubt of their client's guilt by suggesting that either Kronk or Gonzalez could have been the murderer, not purposefully attempting to harm them, and that the lawyers' intent couldn't be imputed to their client anyway.¹²⁶

Note the interpretive approach here. Even though the Bankruptcy Code says that the discharge exception applies to debts "for willful and malicious injury," bankruptcy courts frequently investigate the underlying facts even if they are not elements of the claim. This approach, what we might call the "factual approach," differs sharply from the "categorical approach" used to determine whether a criminal defendant has committed a "crime of violence" or a "violent felony" under federal law.¹²⁷ And it may be on shaky theoretical ground. Bankruptcy courts do not let creditors with debts arising from breach of contract show that such breaches were done with common-law malice and are therefore nondischargeable.¹²⁸ Why should they let creditors with debts arising out of negligence or recklessness torts do so? The answer is not obvious and, to my mind, has more to do with bankruptcy pragmatism than a textualist interpretation of the word "for" in the statute.

¹²⁵ See, e.g., *Thatcher v. Austin (In re Austin)*, 36 B.R. 306, 311–12 (Bankr. M.D. Tenn. 1984) ("[A]pplication of vicarious liability would effectively vitiate the § 523(a)(6) requirement that only debts resulting from the *willful* acts committed *by the debtor* be nondischargeable. Vicarious liability as a social policy or legal fiction ignores the master's knowledge and imposes fault and financial responsibility without regard to culpability or intent.").

¹²⁶ See *Kronk v. Anthony (In re Anthony)*, No. 8:13-bk-00922-RCT, 2019 WL 10734097, at *13–14 (Bankr. M.D. Fla. Feb. 28, 2019). Kronk's attempts to uncover additional evidence ran into an attorney-client privilege problem. *Id.* at *12. Similarly, the bankruptcy court found that Anthony's vague implication of "that girl down in Kissimmee" failed to establish the required intent for nondischargeability because Anthony did not know Gonzalez and did not intend to hurt her specifically. *Gonzalez v. Anthony (In re Anthony)*, 538 B.R. 145, 156 (Bankr. M.D. Fla. 2015).

¹²⁷ See *Taylor v. United States*, 495 U.S. 575, 599–602 (1990).

¹²⁸ But see *Rivera v. Moore-McCormack Lines, Inc.*, 238 F. Supp. 233, 234 (S.D.N.Y. 1965) (holding a debt for breach of contract nondischargeable when the act that breached the contract was done willfully and maliciously).

In the defamation context, this analysis suggests that compensatory damages are usually dischargeable, assuming that the creditors cannot find any additional facts to prove a higher standard of fault. Thus, a debtor can be liable for defamation even without the requisite intent to make the debt nondischargeable in bankruptcy. In *Qui v. Zhou*,¹²⁹ for example, the bankruptcy judge ruled that the debtor, who suffered from schizophrenia, genuinely believed the defamatory allegations, and that the debt was therefore dischargeable.¹³⁰ In *Kanaga v. Landon*,¹³¹ the bankruptcy judge reached the same result without relying on any medical condition, emphasizing that the debtor “genuinely believed” the defamatory material and that the Bankruptcy Code required a higher showing.¹³²

Conversely, punitive damages are almost always nondischargeable in bankruptcy, since state law usually (though not always) requires something like common-law malice.¹³³

Presumed damages create what one court euphemistically called an “analytical wrinkle”: In such claims, called defamatory per se, the law presumes that the victim was injured, without requiring proof of harm.¹³⁴ Bankruptcy courts struggle to determine whether the debtor intended to cause harm when no injury needs to be proven. Instead, many courts focus on whether the debtor knew or was “substantially certain” that the statement was “false and published without privilege.”¹³⁵

¹²⁹ *Qui v. Zhou* (*In re Zhou*), 331 B.R. 274 (Bankr. E.D. Mich. 2005).

¹³⁰ *Id.* at 276–77.

¹³¹ *Kanaga v. Landon* (*In re Landon*), 657 B.R. 128 (Bankr. N.D. Okla. 2024).

¹³² *Id.* at 143–46.

¹³³ See, e.g., *Prozeralik v. Cap. Cities Commc’ns, Inc.*, 626 N.E.2d 34, 42 (N.Y. 1993) (requiring evidence that the defendant acted “out of hatred, ill will, spite, criminal mental state, or that traditionally required variety of common-law malice”); *Combs v. Richardson*, 838 F.2d 112, 117 (4th Cir. 1988) (“We do not imply that every punitive award in a prior tort suit automatically renders the judgment debt nondischargeable in bankruptcy. . . . The standard for punitive damages is established by state law and may vary from the federal requirement for nondischargeability.”).

¹³⁴ See, e.g., *Watson v. Bradsher* (*In re Bradsher*), No. 1:21-CV-1778-SEG (N.D. Ga. Aug. 12, 2022), 2022 WL 3335523, at *5–6.

¹³⁵ *Id.* at *6, *13 (remanding to bankruptcy court to determine whether a defamation defendant knew that his accusations were false).

When a debt contains multiple related dollar amounts, some of which fall into a discharge exception, bankruptcy courts may deem the whole amount nondischargeable. For example, if a judgment contains nondischargeable punitive damages, bankruptcy courts may hold that corresponding compensatory damages are nondischargeable as well.¹³⁶ In *Gober v. Terra + Corporation*,¹³⁷ the Fifth Circuit held that the status of “ancillary obligations”—such as attorneys’ fees and interest—turns on the status of the “primary debt.”¹³⁸

The discharge exceptions apply to individual debtors in chapters 7 and 11, and (with some exceptions) to individual debtors who complete a payment plan under chapters 12 and 13.¹³⁹

Crucially, though, the discharge exceptions do not always apply to businesses: Business entities that reorganize under chapter 11 receive an immediate discharge of almost all claims against them,¹⁴⁰ while companies that are liquidating under chapter 7 of the Code get no discharge at all.¹⁴¹ That leaves small businesses and family-owned farming or fishing businesses, which have special options under the Code. Ambiguous provisions in the Code leave it unclear whether Congress meant to incorporate the discharge exceptions against all debtors in chapter 12 and subchapter V, or just individual debtors. To date, the Fourth and Fifth Circuits have

¹³⁶ See, e.g., *Macris v. Saxton (In re Saxton)*, No. 10-4412-RFN (Bankr. N.D. Tex. June 8, 2011), 2011 WL 2293320, at *8.

¹³⁷ *Gober v. Terra + Corp. (In re Gober)*, 100 F.3d 1195 (5th Cir. 1996).

¹³⁸ *Id.* at 1208.

¹³⁹ See 11 U.S.C. §§ 523, 1141(d)(2), 1228(a)(2), 1328. Chapters 11, 12, and 13 authorize the bankruptcy court to provide a discharge to an individual debtor that has not completed its plan payments, so long as (1) the failure to complete payments “is due to circumstances for which the debtor should not justly be held accountable”; (2) the debtor has made enough payments that the unsecured creditors have received more than they would have in a chapter 7 liquidation; and (3) modification of the plan is impracticable. 11 U.S.C. §§ 1141(d)(5)(B), 1228(b), 1328(b). But neither provision authorizes the judge to include section 523 claims in that hardship discharge. See 11 U.S.C. §§ 1141(d)(2), 1228(c)(2), 1328(c)(2).

¹⁴⁰ Even under chapter 11, corporations cannot get a discharge for debts owed to a state or federal government and obtained by false pretenses or fraud (including debts owed under a *qui tam* statute) or tax or customs duties where the debtor made a fraudulent return or attempted tax evasion. See 11 U.S.C. § 1141(d)(6); 31 U.S.C. §§ 3721–3733.

¹⁴¹ 11 U.S.C. § 727(a)(1).

applied the discharge exceptions to corporate debtors in subchapter V,¹⁴² while several bankruptcy courts have come out the other way.¹⁴³

B. Issue Preclusion in Bankruptcy

When a bankruptcy petition is filed, the automatic stay stops litigation against the debtor in its tracks and the spotlight turns on the bankruptcy court.¹⁴⁴ The petition, though, doesn't always come neatly after a judgment becomes final on appeal. If the debtor files for bankruptcy after committing a defamation tort, but before the case reaches final judgment—or even before a lawsuit is filed—the bankruptcy court has jurisdiction over the claim and must decide whether to hear the matter itself, send it to the district court for a jury trial,¹⁴⁵ or lift the stay and abstain

¹⁴² *Cantwell-Cleary Co. v. Cleary Packaging, LLC* (*In re Cleary Packaging, LLC*), 36 F.4th 509, 512 (4th Cir. 2022); *Avion Funding, LLC v. GFS Indus., LLC* (*In re GFS Indus., LLC*), 99 F.4th 223, 232 (5th Cir. 2024). As of last review before publication, the matter is pending before the Eleventh Circuit. See *BenShot, LLC v. 2 Monkey Trading, LLC* (*In re 2 Monkey Trading, LLC*), No. 23-12342 (11th Cir. July 19, 2023).

¹⁴³ See *Lafferty v. Off-Spec Sols., LLC* (*In re Off-Spec Sols., LLC*), 651 B.R. 862, 867 (B.A.P. 9th Cir. 2023); *Nutrien Ag Sols., Inc. v. Hall* (*In re Hall*), 651 B.R. 62, 67–69 (Bankr. M.D. Fla. 2023); *BenShot, LLC v. 2 Monkey Trading, LLC* (*In re 2 Monkey Trading, LLC*), 650 B.R. 521 (Bankr. M.D. Fla. 2023); *Primary Invs. Grp., Inc. v. Ra Custom Design, Inc.* (*In re Ra Custom Design, Inc.*), No. 23-58494-SMS (Bankr. N.D. Ga. Feb. 13, 2024), 2024 WL 607716, at *2; *Chicago & Vicinity Labs.' Dist. Council Pension Plan v. R&W Clark Const., Inc.* (*In re R&W Const., Inc.*), 656 B.R. 628, 634–38 (Bankr. N.D. Ill. 2024).

¹⁴⁴ 11 U.S.C. § 362.

¹⁴⁵ Whether the bankruptcy court may adjudicate defamation actions depends on whether they are classified as “personal injury” claims, which must be tried in the district court. See 28 U.S.C. §§ 157(b)(2)(B), (O), 157(b)(5), 1411(a). The Supreme Court ducked this very issue in the landmark case of *Stern v. Marshall*, 564 U.S. 462 (2011), ruling that section 157(b) is not jurisdictional and so the defamation plaintiff could consent to the bankruptcy court's jurisdiction. *Id.* at 479. Many lower courts, however, apply a “narrow view” of “personal injury,” requiring some “trauma or bodily injury or psychiatric impairment beyond mere shame or humiliation.” *Byrnes v. Byrnes* (*In re Byrnes*), 638 B.R. 821, 826 (Bankr. D.N.M. 2022); *In re Gawker Media LLC*, 517 B.R. 612 (Bankr. S.D.N.Y. 2017). Under a “middle view,” personal injury can include “emotional and reputational harms,” but not business or financial injuries. See *In re Stewart*, 649 B.R. 755, 760–61 (Bankr. N.D. Ill. 2023) (holding that claims for defamation, stalking, intimidation, and harassment were “personal injury” claims under the Bankruptcy Code, but that tortious interference with a business relationship was not); see also *In re Ice Cream Liquidation*, 281 B.R. 154 (Bankr. D. Conn. 2002); Joseph Collini, *Bankruptcy Court Jurisdiction: Are Libel and Slander Personal Injury Torts?*, 10 ST. JOHN'S BANKR. RSCH. LIBR. 6 (2018), <https://perma.cc/DZ62-HA7D>.

so that another court can proceed with a suit that has already been filed.¹⁴⁶ That determination is a complex one, triggering questions of jurisdiction, comity, federalism, and procedural rights.¹⁴⁷ Bankruptcy judges must decide, among other things, whether allowing a different federal or state court to adjudicate a dispute will disrupt the plan process in bankruptcy court.¹⁴⁸

When litigation between the debtor and a creditor reaches final judgment, and the creditor asks the bankruptcy court to declare the debt nondischargeable, the bankruptcy court will apply standard principles of issue preclusion to that determination.¹⁴⁹ The preclusive effect of a judgment turns on the law in that jurisdiction, but most jurisdictions will give preclusive effect over a prior adjudication of an issue when it is (1) the same issue, (2) actually litigated, (3) between the same parties or

¹⁴⁶ See 28 U.S.C. § 1334(c) (providing for both permissive and mandatory abstention). The bankruptcy court may also abstain from hearing the entire bankruptcy case under 11 U.S.C. § 305. For example, in *Fischer v. Hanson (In re Hanson)*, 171 B.R. 869 (Bankr. D. Minn. 1994), the bankruptcy court abstained to allow the Montana state court to liquidate damages. *Id.* at 872 n.2. Similarly, a bankruptcy court may lift the stay to allow postjudgment motions and appeals to continue. Giuliani, for example, asked the bankruptcy court to lift the stay so that he could pursue remittitur and an appeal of Freeman and Ross’s trial verdict against him. See Debtor’s Motion for an Order Modifying the Stay, *In re Giuliani*, *supra* note 23, ECF No. 25. The bankruptcy court agreed. *Id.*, No. 23-12055 (Bankr. S.D.N.Y. Feb. 20, 2024), 2024 Bankr. LEXIS 954. The district court denied Giuliani’s Rule 50 and Rule 59 motions, see *Freeman v. Giuliani*, No. 21-3354 (D.D.C. Apr. 15, 2024), 2024 WL 1616675, at *20, so Giuliani filed his notice of appeal—before running into further problems in his bankruptcy case. See *supra* note 25 and accompanying text.

¹⁴⁷ See 28 U.S.C. § 1334(c)(1) (authorizing the court to abstain from hearing a bankruptcy proceeding “in the interest of justice, or in the interest of comity with State courts or respect for state law”). For an insightful look at how section 1334 might be amended to address forum-shopping in the bankruptcy context, see Sarah Jones, *Ameliorating Bankruptcy’s Forum Shopping Crisis Through Abstention and Venue Transfer*, 76 FLA. L. REV. 405 (2024).

¹⁴⁸ See *id.* § 1334(c)(2) (requiring the court to abstain if a state-law action, one that could have been brought in federal court only because it is related to the bankruptcy case, has already begun and “can be timely adjudicated” in state court).

¹⁴⁹ See *Grogan v. Garner*, 498 U.S. 279, 284 n.11 (1991) (“Our prior cases have suggested, but not formally held, that the principles of collateral estoppel apply in bankruptcy proceedings under the current Bankruptcy Code. . . . We now clarify that collateral estoppel principles do indeed apply in discharge exception proceedings pursuant to § 523(a).”); see also *Moyer v. Anthony (In re Anthony)*, 648 B.R. 556, 560, 572–77 (Bankr. S.D. Ohio 2023) (finding that willfulness and malice were both necessary to a prior sanctions judgment and holding that debt nondischargeable).

their privies, when that issue was (4) essential to the judgment, which (5) is valid and has become final.¹⁵⁰

For certain claims, a prior judgment can be completely preclusive of the bankruptcy court determination. For example, in *Silas v. Arden*, the Ninth Circuit held that a state court judgment for malicious prosecution had preclusive effect over every element under section 523(a)(6).¹⁵¹ Of course, whether the debtor acted “willfully” and “maliciously” is not always “actually litigated” as part of the prior proceeding.¹⁵² And jury instructions and verdict sheets do not always recite specific facts.

Alex Jones found himself on the wrong side of issue preclusion in bankruptcy. Jones had failed to comply with his discovery obligations in the litigation brought against him in Connecticut and Texas. As a result, both courts deemed the allegations against him admitted and sent the cases to juries for a determination of damages. After Jones filed for bankruptcy, the Sandy Hook parents, now his creditors, followed him to bankruptcy court and argued that Jones could not discharge his debt in bankruptcy.¹⁵³ The bankruptcy judge agreed in part, concluding that the Texas and Connecticut default judgments had preclusive effect in bankruptcy, that the adverse facts had been deemed true, and that Jones was not free to relitigate over \$1 billion in damages—but that the remainder of Jones’s debt, which could

¹⁵⁰ See, e.g., *Lucky Brand Dungarees, Inc. v. Marcel Fashions Grp., Inc.*, 590 U.S. 405, 411 (2020) (“[I]ssue preclusion (sometimes called collateral estoppel) . . . precludes a party from relitigating an issue actually decided in a prior case and necessary to the judgment.”) (citing *Allen v. McCurry*, 449 U.S. 90, 94 (1980)); *Anderson v. Genuine Parts Co.*, 128 F.3d 1267, 1273 (8th Cir. 1997) (setting forth requirements for issue preclusion); see also 18 CHARLES ALAN WRIGHT & ARTHUR R. MILLER, *FEDERAL PRACTICE AND PROCEDURE* § 4416 (3d ed., rev. June 2024).

¹⁵¹ *Silas v. Arden (In re Arden)*, 834 F. App’x 393 (9th Cir. 2021) (mem. op.); see also *Kennedy v. Mustaine (In re Kennedy)*, 249 F.3d 576 (6th Cir. 2001) (same).

¹⁵² See, e.g., *Kanaga v. Landon (In re Landon)*, No. 19-01038 (Bankr. N.D. Okla. Aug. 11, 2020), 2020 WL 4658284, at *8 (holding that a prior state court judgment for defamation did not preclude litigation in bankruptcy court over nondischargeability since the jury verdict allowed for liability on reckless disregard alone). Arbitral awards present the same analytical problem. See *Swan Pediatric Dental, LLC v. Hulse (In re Hulse)*, No. UT-22-001 (B.A.P. 10th Cir. Nov. 8, 2022), 2022 WL 16826561, at *8–11 (holding that arbitration award did not contain sufficient findings of fact for a Utah defamation judgment to preclude the dischargeability determination in bankruptcy).

¹⁵³ See *Heslin v. Jones (In re Jones)*, 655 B.R. 868, 874 (Bankr. S.D. Tex. 2023); *Wheeler v. Jones (In re Jones)*, 655 B.R. 884, 893 (Bankr. S.D. Tex. 2023).

have arisen out of merely reckless conduct, required a fresh look in bankruptcy court.¹⁵⁴

C. Life Under Nondischargeable Debt

Life under nondischargeable debt is not ideal, but some debtors can make it work, particularly if they have sheltered their assets from the bankruptcy process. Such debtors plan to live “below the radar,” avoiding assets and income that would be subject to collection efforts.¹⁵⁵

Every state protects a certain amount of property from collection efforts, called *exempt* property. The exemption laws are both over- and under-inclusive.¹⁵⁶ In 2022, the National Consumer Law Center published an exhaustive report detailing how exemption laws in almost all states fail to protect poor families adequately.¹⁵⁷ Yet wealthy debtors can find ways to shield their assets from debt collection. For instance, debtors who own their primary residence outright can keep their home up to a certain dollar amount in some states and up to a certain acreage in others. That means that some debtors can live out their days in luxurious homes, particularly in states like Texas and Florida, where the homestead exemption is capped by acreage and not by a dollar amount.¹⁵⁸ Similarly, federal law protects a certain percentage of income from garnishment, so debtors may try not to work or to lower their income just enough to avoid the harshest bites from garnishment actions.¹⁵⁹

¹⁵⁴ See *Heslin*, 655 B.R. at 884; *Wheeler*, 655 B.R. at 902–03.

¹⁵⁵ After the bankruptcy ends, the automatic stay terminates, replaced by the discharge injunction. The injunction permanently enjoins creditors from attempting to collect on the debt. See 11 U.S.C. § 524(a).

¹⁵⁶ See, e.g., Christopher D. Hampson, *Harsh Creditor Remedies & the Role of the Redeemer*, 92 FORDHAM L. REV. 935, 954–55 (2023) (describing state exemption laws and arguing that they protect not only the debtor but also the debtor’s family).

¹⁵⁷ Michael Best & Carolyn Carter, *No Fresh Start 2022: Will States Let Debt Collectors Push Families Into Poverty as the Cost of Necessities Soars?*, NAT’L CONSUMER L. CTR. (Dec. 2022), <https://perma.cc/K537-S825>.

¹⁵⁸ See, e.g., Hampson, *supra* note 156, at 937 n.2; see also TEX. PROP. CODE ANN. § 41.001 (West 2024); FLA. CONST. art. X, § 4; ELIZABETH WARREN, JAY LAWRENCE WESTBROOK, KATHERINE PORTER & JOHN A.E. POTTOW, *THE LAW OF DEBTORS AND CREDITORS* 73–83 (8th ed. 2014) (describing uncapped homestead exemptions).

¹⁵⁹ See 15 U.S.C. § 1673.

And since the nondischargeable debt is *ad personam*, debtors can continue to live off of spendthrift trusts or the largesse of friends, family, or political allies.¹⁶⁰

III. THE FIRST AMENDMENT IN BANKRUPTCY COURT

Enter the First Amendment. The First Amendment affects defamation claims in two ways. First, under *New York Times* and its progeny, plaintiffs who are public figures must show that the defendant acted with “actual malice,” by clear and convincing evidence.¹⁶¹ And second, under *Gertz*, plaintiffs must show “actual malice” for presumed or punitive damages. That heightened showing applies “by analogy” in the context of labor disputes, where states may adjudicate “actual malice” defamation claims but other claims fall within the preemptive scope of the National Labor Relations Act.¹⁶²

These First Amendment requirements are hotly litigated outside bankruptcy court, but scholars and practitioners alike have all but ignored what they could mean inside bankruptcy court.¹⁶³ In this Part, I explain the differences between constitutional law’s “actual malice” test and bankruptcy law’s “willful and malicious” test. I also point out that the First Amendment applies just as much to insolvency rules as it does to liability rules—a point that is obviously true but commonly forgotten. While section 523 is constitutional as written, the First Amendment governs Congress’s power to pass a discharge law.

A. “Actual Malice” and Dischargeability

As noted above, a claim is nondischargeable in bankruptcy when it is for “willful and malicious injury.”¹⁶⁴ On the surface, it might appear that a plaintiff who can demonstrate “actual malice” for First Amendment purposes can also show “willful and malicious injury” for bankruptcy purposes. But the Supreme Court has clari-

¹⁶⁰ Indeed, such spendthrift trusts are enforceable even in bankruptcy court, although transfers to the trust might be challenged as fraudulent transfers. See 11 U.S.C. § 541(c)(2).

¹⁶¹ See *supra* notes 55–60 and accompanying text.

¹⁶² *Linn v. United Plant Guard Workers of Am.*, 383 U.S. 53, 65 (1966); see also Kati L. Griffith, *The NLRA Defamation Defense: Doomed Dinosaur or Diamond in the Rough?*, 59 AM. U. L. REV. 1, 10–13 (2009) (describing *Linn*’s doctrinal history and warning against restricting the scope of the NLRA’s preemption).

¹⁶³ See *supra* notes 3–13 and accompanying text (discussing the literature).

¹⁶⁴ 11 U.S.C. § 523.

fied that the “actual malice” test in constitutional law can be met by “reckless disregard of the truth,”¹⁶⁵ while the discharge exception in bankruptcy requires a higher showing than recklessness.¹⁶⁶

Put simply, the discharge exception in bankruptcy requires a higher showing of culpability than the First Amendment does. Two conclusions follow:

First, even when “actual malice” is a requirement for liability, including presumed or punitive damages and debt owed to public figures, the debt may still be dischargeable in bankruptcy. Bankruptcy courts would have to look beneath any finding of “actual malice” to see whether the underlying facts met the bankruptcy standard. The constitutional standard does not settle the issue.

Second, and relatedly, a prior adjudication of the “actual malice” standard does not predetermine the bankruptcy outcome under standard issue preclusion rules, as they are not the same issue.¹⁶⁷

B. Section 523 as Speech Regulation

We might also wonder whether section 523 of the Bankruptcy Code could run afoul of the First Amendment. If the Free Speech Clause governs liability rules, does it also govern insolvency rules? The answer is clearly *yes*. I see no legal or policy reason that the Constitution should apply to liability and not to discharge. That said, I also see no free speech issues with section 523 as it stands today.

As a threshold matter, Congress has the power to pass a statute granting a discharge for debtors. The U.S. Constitution gives Congress the power to enact uniform bankruptcy laws,¹⁶⁸ just as it restricts states from impairing contracts.¹⁶⁹ Conversely, most commentators believe that individuals have no constitutional right to

¹⁶⁵ See *St. Amant v. Thompson*, 390 U.S. 727, 728, 731–34 (1968).

¹⁶⁶ See *supra* note 117 and accompanying text.

¹⁶⁷ See *supra* notes 149–150 and accompanying text.

¹⁶⁸ U.S. CONST. art. I, § 8, cl. 4.

¹⁶⁹ U.S. CONST. art. I, § 10, cl. 1; *Sturges v. Crowninshield*, 17 U.S. 122, 208 (1819) (holding that Congress may pass discharge laws pursuant to the Bankruptcy Clause but that states may not, as such laws violate the Contracts Clause). At the same time, of course, the Constitution prohibits the federal government from taking “property.” See, e.g., *Tyler v. Hennepin Cnty.*, 598 U.S. 631, 647–48 (2023) (seizure of \$40,000 house sold for \$15,000 tax debt was an unconstitutional taking). Scholars have long questioned whether stripping or cramming down a secured creditor’s interest in property (a lien) might be a taking subject to constitutional scrutiny. Everyone agrees that the matter is fine prospectively, so long as secured creditors take their lien subject to whatever rules are in force.

the discharge that would stop Congress from repealing it.¹⁷⁰ In fact, the country had no bankruptcy laws at all for more than one hundred years of its history.¹⁷¹

But constitutional law frequently imposes limits on *how* Congress acts, even if it need not act at all. A discharge provision intended to benefit members of a favored religion (or to punish members of a disfavored religion) would violate the Free Exercise Clause.¹⁷² Similarly, a discharge provision that discriminates on the basis of protected classes would likely violate the Equal Protection Clause.¹⁷³

The First Amendment, then, governs how the Bankruptcy Code treats debt arising out of speech. To be sure, most debts that come into bankruptcy court have nothing to do with speech at all, and many of the debts deemed “nondischargeable” by bankruptcy judges are rooted in conduct, not speech. But by excepting speech-related debts from the discharge, section 523 does burden speech, both for defamation debt that rises to the level of “willful and malicious injury” and for money obtained through false representations.¹⁷⁴

This means that Congress may be subject to some constitutional limitations if it wanted to *reduce* the rights available to secured creditors in bankruptcy retrospectively.

¹⁷⁰ See *United States v. Kras*, 409 U.S. 434, 446–47 (1973) (dealing with a filing fee for bankruptcy, and distinguishing *Boddie v. Connecticut*, 401 U.S. 371 (1971)).

¹⁷¹ See *Kras*, 409 U.S. at 434.

¹⁷² See, e.g., *Church of the Lukumi Babalu Aye, Inc. v. City of Hialeah*, 508 U.S. 520, 547 (1993) (holding that the City of Hialeah’s ordinances prohibiting ritual animal sacrifices violated the Free Exercise Clause because they were neither neutral nor generally applicable).

¹⁷³ For example, in *DuPhily*, the bankruptcy court ruled that court-ordered support payments for a child born to unmarried parents were nondischargeable, even though the statute seemed to limit the discharge exception only to support payments arising out of separation or divorce. See *DuPhily v. DuPhily*, 52 B.R. 971, 976 (D. Del. 1985); see also *Pierson v. Toman* (*In re Pierson*), 47 B.R. 258, 260–61 (Bankr. D. Neb. 1985) (same). When no protected class is implicated, courts have found no constitutional infirmity in section 523. For example, *Dalkon Shield* argued that it violated equal protection for the discharge to apply differently to individuals as to corporations. *Beard v. A.H. Robins. Co.*, 828 F.2d 1029, 1031 (4th Cir. 1987). The Fourth Circuit rejected that approach. *Id.* at 1031–32. A similar challenge to section 523’s provisions concerning taxes also failed, see *Wood v. United States* (*In re Wood*), 866 F.2d 1367, 1370–72 (11th Cir. 1989), as did various equal protection challenges to the student loan debt provisions, see *McClain v. Am. Student Assistance* (*In re McClain*), 264 B.R. 230, 232–34 (Bankr. D.N.H. 2001); *Logal v. Educ. Credit Mgmt. Corp.* (*In re Logal*), 381 B.R. 706, 713–17 (Bankr. N.D. Ind. 2007).

¹⁷⁴ See 11 U.S.C. § 523(a)(2), (6).

Indeed, the way that legal entitlements are processed in bankruptcy is arguably more important than the pre-bankruptcy system of liability rules or property rules.¹⁷⁵ Liability is a waystation on the journey through debt collection and into bankruptcy court. And enforcement of legal entitlements takes on a whole different dimension when the debtor files for bankruptcy. Insolvency rules, in that way, can have a much more profound impact on a debtor's life—and creditors' lives—than liability rules or property rules.

That said, the discharge exception turns on the mental state of the debtor, not the content of the speech itself, and thus needs to meet only intermediate scrutiny.¹⁷⁶ Beyond that, the discharge provision stands at a much higher standard than what the First Amendment requires for liability. By excepting only debts for “willful and malicious injury” (or for money obtained through falsehood or fraud) from the discharge, Congress is operating well within its constitutional zone. Put differently, the Bankruptcy Code protects *more* speech than the First Amendment does.

But that does not mean that the First Amendment has nothing to say about bankruptcy's discharge provisions. Congress's discharge power is cabined by the Constitution.

First, Congress clearly cannot slant section 523. For instance, if Congress amended the Bankruptcy Code to provide a discharge for some types of speech-related injuries and not others, based on viewpoint, that disparity would violate the First Amendment's clear prohibition on viewpoint discrimination.¹⁷⁷

Second, I doubt that Congress could treat negligent speech less favorably than negligent conduct. So long as the Bankruptcy Code offers a discharge for debts for negligent conduct, it must offer the same discharge for debts for negligent speech. Any other rule would treat constitutionally protected speech less favorably than

¹⁷⁵ Judge Guido Calabresi and Professor A. Douglas Melamed's seminal 1972 article set forth a typology for understanding legal entitlements based on how the legal system enforces them. See Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972). Perhaps Calabresi and Melamed can be forgiven for ignoring this dimension since their article antedates the Bankruptcy Code of 1978, which renewed interest in insolvency as a key part of the legal system.

¹⁷⁶ See, e.g., *Turner Broad. Sys., Inc. v. F.C.C.*, 512 U.S. 622, 662 (1994).

¹⁷⁷ See, e.g., *Nat'l Rifle Ass'n of Am. v. Vullo*, 602 U.S. 175, 187 (2024) (“At the heart of the First Amendment's Free Speech Clause is the recognition that viewpoint discrimination is uniquely harmful to a free and democratic society.”).

conduct, which is outside the protection of the Free Speech Clause. For example, imagine that Congress decided to crack down on “fake news” by making all defamation debt nondischargeable, regardless of the level of culpability. Such a reform would violate both First Amendment and equal protection principles. Indeed, the Supreme Court in *Gertz* noted that the “legitimate state interest underlying the law of libel is the compensation of individuals,” especially “compensation for actual injury.”¹⁷⁸ But that interest is at a nadir in bankruptcy, where not everyone is paid in full.

IV. BANKRUPTCY ADVICE FOR DEFAMATION COUNSEL

This analysis gives rise to an all-important set of questions for defamation counsel: When should you think about bankruptcy and what steps should you take in advance?

For those who don’t think about bankruptcy all the time, I offer the following rubric: Think about bankruptcy unless the defendant could readily pay a reasonable settlement amount without facing financial distress—and that’s on both the plaintiff-side and defendant-side of the table. Put differently, bankruptcy comes into play whenever insolvency is on the horizon.¹⁷⁹

This Part examines some of the strategic considerations that both sides should take into account and concludes with some systemic concerns and normative suggestions from the bankruptcy perspective.

A. *Strategic Considerations for Plaintiffs’ Counsel*

Defamation plaintiffs have many goals: their day in court, vindication for wrongs, compensation for injury, and (sometimes) punitive damages as well. As described earlier,¹⁸⁰ procedural goals can be frustrated by a bankruptcy filing. Remember that the defendant may file for bankruptcy upon receiving a demand letter,

¹⁷⁸ *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 341, 349 (1974).

¹⁷⁹ Insolvency professionals regularly think about three types of insolvency: first, when liabilities outweigh assets (balance-sheet insolvency); second, when a debtor has insufficient liquidity to service its debt (cash flow insolvency); and third, when a debtor has insufficient funds to undertake its chosen course of business (insufficient capital). See 11 U.S.C. § 101(32)(A) (defining insolvency as when “the sum of such entity’s debts is greater than all of such entity’s property, at a fair valuation,” *i.e.*, the balance sheet test); *EBI, Inc. v. Am. Online, Inc.* (*In re EBI*), 380 B.R. 348, 355 (Bankr. D. Del. 2008) (citing 11 U.S.C. § 548(a)(1)(B)(ii)(III) & (II) for cash flow and inadequate capital tests), *aff’d*, 382 F. App’x 135 (3d Cir. 2010).

¹⁸⁰ See *supra* Section II.B.

after the jury leaves to deliberate, or even immediately after the judge enters the final judgment. The bankruptcy petition will create an automatic stay, and the plaintiff will have to stop everything and head to bankruptcy court. If the bankruptcy petition is filed early, the plaintiff may be relegated to airing out her claim before the bankruptcy judge. But if the parties have already completed significant work in the defamation case, the plaintiff may be able to ask the bankruptcy judge to abstain and let the prior court finish its work.¹⁸¹

Bankruptcy can frustrate monetary goals as well. If the plaintiff's claim is only for negligent or reckless conduct, a defendant may be able to discharge that claim in bankruptcy.¹⁸² That result does not always mean that the plaintiff will recover nothing: The defamation claim will be placed alongside all other sorts of unsecured, nonpriority debt, receive cents on the dollar, and then be discharged at the end of the case. The ultimate treatment of the claim will turn on many factors, including whether the case is proceeding under chapter 7, chapter 11, chapter 12, or chapter 13 of the Bankruptcy Code.¹⁸³

Strategically, then, if the defendant's conduct was intentional, plaintiff's counsel may wish to make *intent to harm* a theme of the case by seeking punitive damages and by proving facts that a bankruptcy judge could rely on for a "willful and malicious injury" determination. That means building a factual record that shows not only constitutional malice, but also common-law malice. In jurisdictions that allow jury forms to include specific questions, plaintiff's counsel may wish to ask the jury whether it concluded that the defendant intended to harm the plaintiff.¹⁸⁴ Such a finding would likely be given issue-preclusive effect by a bankruptcy judge.

¹⁸¹ See *supra* note 147.

¹⁸² This, of course, depends on whether plaintiffs' counsel can submit additional factfinding to the bankruptcy court showing that the debtor caused the injury willfully and maliciously. See *supra* Section II.A.

¹⁸³ In particular, if an individual debtor proceeds under chapter 13 of the Code, plaintiff's counsel should analyze whether the jurisdiction takes a broad or narrow view of "personal injury" under the Code. See *infra* notes 208–210 and accompanying text.

¹⁸⁴ See Steve Zansberg, *How Best to Explain "Actual Malice" to Juries? For Starters, Don't Use Those Words*, A.B.A. (June 9, 2023), <https://perma.cc/FNV6-J8RN>.

If a plaintiff decides to settle before reaching judgment, bankruptcy may disrupt her expectations for a settlement payout. Most settlements do not address bankruptcy at all,¹⁸⁵ and if the settlement is “bare,” *i.e.*, containing no admissions of fact, it may be treated as merely establishing a dischargeable debt in bankruptcy court—or, at minimum, that issue will need to be relitigated.¹⁸⁶ Accordingly, if the plaintiff has the negotiating power to do so, she should seek to include factual admissions in the settlement, or ask for a stipulated judgment in case the defendant fails to pay.¹⁸⁷ The text of the judgment must be carefully drafted if it is to have preclusive effect in bankruptcy court. Because a defendant cannot prospectively bind the bankruptcy court by admitting that the debt is for “willful and malicious injury under section 523(a)(6) of the Bankruptcy Code,”¹⁸⁸ it is better to focus on facts that will bring the bankruptcy judge to that conclusion, instead of stating the conclusion in the settlement agreement.¹⁸⁹

Structured settlements can be landmines in bankruptcy. A structured settlement turns the plaintiff into a creditor and the defendant into a debtor. If the de-

¹⁸⁵ Christopher B. Lega, *Protecting Settling Plaintiffs When a Defendant Goes Bankrupt*, 101 ILL. BAR J. 200, 200 (2013).

¹⁸⁶ As noted above, *supra* notes 121–128 and accompanying text, the bankruptcy court will likely conduct additional factfinding to determine whether the underlying claim was for “willful and malicious” conduct. In the related section 523 of context of debts for “money obtained by fraud,” the Supreme Court has rejected the theory that a settlement works a sort of novation, requiring bankruptcy courts to look through the settlement to the claim it settled. *See Archer v. Warner*, 538 U.S. 314, 318–23 (2003).

¹⁸⁷ *See Son v. Park*, No. C 10–00085 MHP (N.D. Cal. Nov. 19, 2010), 2010 WL 4807089, at *1–3; *see also Lega, supra* note 185, at 203; *Fifth Third Bank v. Baumhaft (In re Baumhaft)*, 271 B.R. 523, 525–27 (Bankr. E.D. Mich. 2001).

¹⁸⁸ Bankruptcy courts typically do not enforce prepetition waivers of dischargeability, but they may enforce stipulations of facts that lead to that conclusion, particularly if the stipulation is entered by the court as a consent judgment. *See Ira L. Herman, Settlement Agreements in Bankruptcy*, LEXISNEXIS (Oct. 12, 2022) (citing *Lichtenstein v. Barbanel*, 161 F. App’x 461, 468 (6th Cir. 2005)); *Klingman v. Levinson*, 831 F.2d 1292, 1296 n.3 (7th Cir. 1987).

¹⁸⁹ *See Lega, supra* note 185, at 203 (discussing *Nw. Bank & Tr. Comp. v. Edwards (In re Edwards)*, 439 B.R. 870, 873–74 (Bankr. C.D. Ill. 2010)); *see also Minor v. United States (In re Minor)*, No. 21-55360 (9th Cir. Apr. 18, 2022), 2022 WL 1135391, at *2 (denying preclusive effect to a stipulation between the IRS and the bankruptcy trustee because it was not intended to settle dischargeability and the debtor was not privy to the agreement).

fendant is insolvent at the time of entering into the settlement, the bankruptcy trustee or other creditors could challenge the settlement agreement as a fraudulent transfer, if they believe that the defendant settled for an unreasonable amount.¹⁹⁰ After payments have been made, the bankruptcy trustee may be able to claw them back into the bankruptcy estate under preference law, arguing that the defamation plaintiff is getting repaid more than other creditors.¹⁹¹

Remember that, as discussed above, the discharge exceptions only apply to individual defendants. While a judgment against a company (like Free Speech Systems) may be appealing for other reasons, those debtors may try to reorganize under chapter 11 or 12 and shed the debt.

Lastly, keep in mind that the bankruptcy discharge covers only the debt of the debtor, not other entities.¹⁹² If a plaintiff can bring claims against two or more defendants, her ability to recover is strengthened, since one defendant might file for bankruptcy while the other does not. Similarly, when a debtor files for bankruptcy, its insurance company (usually) stays solvent, providing another pot of money against which a plaintiff may seek relief.¹⁹³

B. Strategic Considerations for Defendants' Counsel

On the defense side, when a defamation case presents a risk of financial distress, a defendant may wish to retain bankruptcy counsel to determine whether a bankruptcy filing might be a viable strategic move. Preparing a well-organized filing in advance can ward off all sorts of problems, and the legal team will have to consider

¹⁹⁰ See 11 U.S.C. §§ 544, 548.

¹⁹¹ See 11 U.S.C. § 547. Bankruptcy attorneys can advise several ways to structure payment streams to avoid these problems, including taking a security interest, preserving the claim's full value until the preference period has passed, requesting a guaranty from a third party, or requiring that payments be made directly by a third party (or if routed through the debtor, protected under the earmarking doctrine). See *Lega*, *supra* note 185, at 202–03; Herman, *supra* note 188.

¹⁹² This point is especially poignant after the Supreme Court's decision in *Purdue Pharma*, ruling that bankruptcy judges have no statutory authority to issue nonconsensual third-party releases. See *Harrington v. Purdue Pharma L.P.*, 144 S. Ct. 2071, 2088 (2024).

¹⁹³ If the debtor files for bankruptcy, however, its insurance policy will likely be considered property of the estate under section 541 and therefore subject to the automatic stay. See 11 U.S.C. § 541. While a claimant's rights to the proceeds of the insurance policy may have stronger footing than claims against the debtor, claimants will have to be careful not to violate the automatic stay. See 11 U.S.C. § 362.

whether and when to file. While it may be appealing to yank a case away from an unsympathetic judge or jury, the bankruptcy judge may use the Code's abstention rules to place the defendant right back before the same factfinder, irritated all the more for the defendant's dilatory actions.¹⁹⁴

Naturally, defense counsel will want to understand not only the size of the claims against the client, but also whether any judgments or settlements are likely to be dischargeable in bankruptcy should the client ever need it. Defense counsel will, of course, attempt to dispose of the case through anti-SLAPP laws,¹⁹⁵ but if they cannot, even getting rid of claims for punitive damages on a motion to dismiss or a motion for summary judgment will significantly cabin the downside risk for the client: Whatever's left is more likely to be dischargeable in bankruptcy. Similarly, if the judge is amenable to a bifurcated trial, where liability is determined before damages, that approach might help the client grapple with the economic and emotional consequences of a loss.

As above, analyze individual defendants and corporate defendants separately. While defamation debt owed by an individual debtor may fall under a discharge exception, debt owed by a business debtor can be cleared away if the debtor can restructure under chapter 11 or 12.

Just as plaintiffs must think about settlements, so too must defendants. Depending on the defendant's negotiating power, defense counsel should try to settle without any admissions of guilt that could adversely affect the client's rights in bankruptcy court. If the plaintiff asks for a stipulated judgment, make sure that the judgment does not contain anything that would preclude the ability to argue that it is dischargeable later on. For the defendant's side, structured settlements are ideal, because they establish an ongoing debt that could be disrupted by a bankruptcy filing in the future.

As with plaintiff-side counterparts, co-defendants and insurance companies will be a key part of any strategic approach to the case.

¹⁹⁴ See *supra* notes 146–148 and accompanying text.

¹⁹⁵ See, e.g., D.C. CODE ANN. § 16-5502 (West 2012); *Abbas v. Foreign Pol'y Grp., LLC*, 783 F.3d 1328, 1331 (D.C. Cir. 2015) ("But the D.C. Anti-Strategic Lawsuits Against Public Participation Act of 2010 (known as the Anti-SLAPP Act) requires courts, upon motion by the defendant, to dismiss defamation lawsuits that target political or public advocacy, unless the plaintiff can show a likelihood of success on the merits.").

Lastly, remember that bankruptcy reorganizes only prepetition debt.¹⁹⁶ This means, of course, that the client should not file for bankruptcy unless they have already gotten all the defamation out of their system, so to speak. Any defamation that takes place after the bankruptcy petition has been filed cannot be discharged.¹⁹⁷ To the same end, a plan of reorganization in bankruptcy cannot be confirmed unless the judge is satisfied that it is unlikely to be followed by another bankruptcy case.¹⁹⁸ For both reasons, after a bankruptcy filing, defamation defendants would be well advised to adjust their speech patterns to avoid future liability.

C. Systemic Concerns from the Bankruptcy Perspective

The rise in defamation exposure, along with its potential for nondischargeability in bankruptcy, raises thorny systemic concerns. To some degree, the groundswell in liability may be a good thing—social media has made it easier than ever for a lie to “travel halfway around the world while the truth is still putting on its shoes,” as the saying goes.¹⁹⁹ And defamation torts provide compensation for dignitary harms, disincentivize reckless speech, and promote the virtue of honesty in public life.²⁰⁰ Yet if liability has a chilling effect on speakers, the threat of nondis-

¹⁹⁶ 11 U.S.C. § 1141(d)(1)(A).

¹⁹⁷ 11 U.S.C. § 727(b). Donald Trump, for example, continued to defame E. Jean Carroll after the first jury verdict in her favor and has publicly promised to repeat his claims “a thousand times.” See RonNell Andersen Jones, *The E. Jean Carroll Verdict Exposes the Limits of Libel Law*, N.Y. TIMES (Jan. 28, 2024), <https://perma.cc/E4HU-CGKL>. While every additional act of defamation broadens Trump’s legal exposure, much of it might be dischargeable in bankruptcy because all of it has occurred before any bankruptcy filing.

¹⁹⁸ 11 U.S.C. §§ 1129(a)(11); 1112(b)(4). This provision was part of what induced the bankruptcy judge to dismiss Gateway Pundit’s bankruptcy case, though the judge framed it as a business-model problem. See *In re TGP Commc’ns, LLC*, No. 24-13938 (Bankr. S.D. Fla. July 25, 2024), 2024 WL 3548248, at *10 (noting that the debtor’s “brash (and allegedly not fact-checked) reporting style” had been challenged in court and that “a more restrained editorial style” could “soften revenue”).

¹⁹⁹ In a textbook example of irony, the source of this quote is often misattributed to Mark Twain and others, but likely traces back to Jonathan Swift. See Niraj Chokshi, *That Wasn’t Mark Twain: How a Misquotation Is Born*, N.Y. TIMES (Apr. 26, 2017).

²⁰⁰ The interplay between these values and free speech is complex and dynamic. In a new book, Prof. Rachel Bayefsky argues that “freedom of expression values” and dignitarian values might be mutually defining—and points out that public figures accept “some risk of dignitary harm” by stepping into power. RACHEL BAYEFISKY, *DIGNITY AND JUDICIAL AUTHORITY* 104–08 (2024).

chargeable debt is positively freezing. We may be tempted to shrug away this concern, especially when the speaker is someone like Alex Jones or Rudy Giuliani—but how about when the speaker is a women sharing her #MeToo experience of sexual harassment and staring down a defamation suit in response?²⁰¹ Yet we need a single, content-neutral rule for all of it. And amidst growing concerns that defamation liability has been weaponized, bankruptcy law may need to stretch a little to preserve the goal of providing a fresh start for the “honest but unfortunate debtor.”²⁰²

Right now, bankruptcy law only declares defamation debts nondischargeable when they are for *intentional misconduct*, a standard that is higher than anything the First Amendment demands and one that excepts from bankruptcy’s forgiveness the most egregious offenses. Section 523 is evenhanded when it comes to viewpoint, content, or conduct distinctions. We are, therefore, a healthy distance away from any free speech problem.

This is not to say, of course, that section 523 is above reproach. Far from it. Scholars like Professors Abbye Atkinson, Angela Littwin, and Nicole Langston have underscored a number of places where the Code does not seem to reflect fair, efficient, or formative results. Nondischargeable criminal justice debt weighs down poor and minority populations in overpoliced jurisdictions.²⁰³ Nondischargeable student loans overburden student borrowers trying to build a new career.²⁰⁴ And nondischargeable debt “obtained by fraud” can haunt borrowers, particularly women, in coercive or violent domestic relationships.²⁰⁵ At a minimum, bankruptcy should provide a fresh start for contractual debts, debts imposed without

²⁰¹ For an incisive analysis of how women’s speech that injures men’s reputations is recast as violent speech, see Mary Anne Franks, *Witch Hunts: Free Speech, #MeToo, and the Fear of Women’s Words*, 2019 U. CHI. LEGAL F. 123.

²⁰² *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (citing *Williams v. U.S. Fidelity & Guaranty Co.*, 236 U.S. 549, 554–55 (1915)).

²⁰³ See *supra* notes 3–4 and accompanying text (citing articles by Atkinson and Langston).

²⁰⁴ See, e.g., Rafael I. Pardo & Michelle R. Lacey, *Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt*, 74 U. CIN. L. REV. 405, 414, 419–32 (2005); Hunt, *supra* note 5, at 727–30; Pottow, *supra* note 5, at 245–47.

²⁰⁵ See *supra* note 7 (citing articles by Littwin).

any finding of fault, and even debts that are labeled “criminal” but function more like taxes.²⁰⁶

Beyond that, perhaps we should take far more seriously the call to forgive even debts arising from morally repugnant behavior—especially after good faith efforts to repay. For bankruptcy’s discharge is not just about fairness or efficiency; it is also a place where the legal system can cultivate virtue, as Heidi Hurd and David Baum have persuasively argued.²⁰⁷ We can cultivate the virtue of responsibility in debtors by extending the discharge after reformed behavior and good faith efforts to repay. And we can cultivate the virtue of mercy in the legal system by forgiving old debts or debts that create undue hardship.

Indeed, in some jurisdictions, defamation debt may be one of the few types of debt that a debtor can “work off” through a chapter 13 plan. The Bankruptcy Code used to include more debts in the chapter 13 discharge, which a debtor receives after paying disposable income to creditors over a three- to five-year period, something commentators once called a “super-discharge.” Today, the difference between the chapter 13 discharge and the chapter 7 discharge is almost negligible.²⁰⁸ But the chapter 13 discharge can forgive debts for willful and malicious injury, so long as the injury did not cause “personal injury to an individual or the death of an individual.”²⁰⁹ In a jurisdiction that follows the “narrow” approach to personal injury, the reputational or emotional effects of defamation would be insufficient to bring defamation claims within the discharge exception of a chapter 13 case, clearing the way for a payment plan followed by forgiveness.²¹⁰ That said, not all courts

²⁰⁶ See, e.g., Christopher D. Hampson, *The New American Debtors’ Prisons*, 44 AM. J. CRIM. L. 1, 3–8 (2016).

²⁰⁷ See Heidi M. Hurd & David C. Baum, *The Virtue of Consumer Bankruptcy*, in A DEBTOR WORLD: INTERDISCIPLINARY PERSPECTIVES ON DEBT 217, 221–22 (Ralph Brubaker, Robert Lawless & Charles Tabb eds., 2012).

²⁰⁸ For this reason, a consumer debtor’s only incentive to embark upon a payment plan in bankruptcy (unless forced into it by the means test) is to preserve collateral, typically a house or a car—not to work off nondischargeable debt.

²⁰⁹ See 11 U.S.C. § 1328(a)(2) (omitting subsection (a)(6)); (a)(4); see also *Hardin v. Caldwell* (*In re Caldwell*), 895 F.2d 1123, 1126 (6th Cir. 1990).

²¹⁰ See *supra* note 145.

follow this approach. Other jurisdictions consider defamation torts to count as personal injury torts.²¹¹

Reinvigorating the “super-discharge” would not fix the other problems with a dual pathway model to individual bankruptcy, especially the inefficiency, unfairness, and poor formation introduced to the system by “chapter choice.”²¹² Thus, along with many other scholars,²¹³ I have called for abolishing the dual pathway and creating a single chapter 10 for all individual debtors with debts of less than \$7.5 million.

Under either model, though, the discharge exceptions could be amended to allow for greater forgiveness of debts. Indeed, we have precedent for a more magnanimous approach. Under the law as it stands today, older tax debts can be discharged in bankruptcy (newer tax debts cannot).²¹⁴ Student loans can be discharged when repaying them would create “undue hardship,” a standard that usually requires a showing of good faith efforts to repay.²¹⁵ We could combine those approaches to require that individual debtors owing certain nondischargeable debts make good faith efforts to repay over a period of years before becoming eligible for a bankruptcy discharge. Imposing this requirement through section 523 would avoid the problem of plan failure and allow debtors living under nondischargeable debt to make arrangements to repay before filing for bankruptcy.

Business debtors present tougher challenges. InfoWars filed for subchapter V, the small-business chapter that would have entitled Alex Jones to reclaim his business after making three to five years of payments. If such entities owe debts that would be nondischargeable under section 523(a), the debtors in those cases (and their owners) will need to know whether section 523(a) applies to business entities reorganizing under subchapter V.²¹⁶ The statutory interpretation question is

²¹¹ *Id.*

²¹² See, e.g., Langston, *supra* note 4, at 1145, 1153–55.

²¹³ See Letter from Richard Alderman et al., to Hon. Elizabeth Warren (Sept. 28, 2022), <https://perma.cc/GE59-KF9X>.

²¹⁴ See 11 U.S.C. § 523(a)(1), (7).

²¹⁵ See *supra* note 202.

²¹⁶ See *supra* notes 142–143 and accompanying text (collecting cases).

vexed,²¹⁷ but as a policy matter, applying the discharge exceptions to subchapter V debtors may make some sense: Since the company will be returned to its former owners after the payment period, the discharge exceptions ensure that the bankruptcy case is not being used to wipe away debts arising out of misconduct before delivering the company back to the old owner. In a regular chapter 11, the absolute priority rule serves some of the same function: ensuring that old equity cannot walk away with the company, unless the former owner provides cash or procures consent.

Going a step further, we may wish to revisit the rule that the discharge exceptions do not apply to businesses reorganizing under chapter 11 of the Code, a policy decision tracing back to 1978. As Gross points out, the discharge exception for “willful and malicious” injury used to apply to both individuals and corporations.²¹⁸ There are, of course, sometimes good reasons to treat businesses differently than individuals. Defunct corporations can wind down and dissolve under state law; individuals cannot. Nevertheless, as Prof. Melissa Jacoby has recently laid bare in her book *Unjust Debts*, the bankruptcy system too frequently makes escaping debt much easier for large corporations than it does for small corporations and individuals.²¹⁹

²¹⁷ For a brief discussion of the state-of-play, see Christopher D. Hampson & Jeffrey A. Katz, *The Small Business Prepack*, 92 GEO. WASH. L. REV. 101, 126 n.133 (2024). Regardless of how one comes out, the statutory text in subchapter V, “of the kind specified in section 523(a),” 11 U.S.C. § 1192(2), and in chapter 12, “of a kind specified in section 523(a),” *id.* § 1228(a)(2), ought to have the same effect—the difference between the definite article “the” and the indefinite article “a” is too thin to bear the weight of such an important distinction. For an argument that subchapter V does not incorporate discharge exceptions against corporate debtors, see Hon. Paul W. Bonapfel & Robert Schaaf, *Do 523(a) Exceptions to Discharge Apply to the Discharge of a Corporation in a Subchapter V Case After “Cramdown” Confirmation Under Section 1191(b)?*, 32 NORTON J. BANKR. L. & PRAC. art. 1 (2023). In particular, the ABI Task Force has noted that applying discharges to corporations would be a significant change in bankruptcy policy from the 1978 Code, and Congress would presumably have made such a substantial change more expressly or with stronger legislative history. See HON. MICHELLE M. HARNER ET AL., AM. BANKR. INST. SUBCHAPTER V TASK FORCE, FINAL REPORT OF THE AMERICAN BANKRUPTCY INSTITUTE SUBCHAPTER V TASK FORCE 591–92 (2024).

²¹⁸ See Gross, *supra* note 9, at 483 n.10 (citing Bankruptcy Act of 1898, 30 Stat. 544, 550–51, § 17(a). As Gross notes, however, the 1978 Bankruptcy Code applied this section to individuals only, and Congress last reconsidered that approach in 2005. *Id.*

²¹⁹ MELISSA JACOBY, UNJUST DEBTS: HOW OUR BANKRUPTCY SYSTEM MAKES AMERICA MORE UNEQUAL 63–89 (2024).

Of course, such a change could have unintended consequences: Nondischargeable debt could induce more business debtors to sell the company or avoid bankruptcy altogether.²²⁰ And it could disrupt the genius of chapter 11, namely, to wipe out old equity through the absolute priority rule while forcing creditors to make a deal by binding holdouts. Perhaps for this reason, the American Bankruptcy Institute's Subchapter V Task Force recommended a statutory tweak to confirm that the discharge exceptions do not apply to business entities in subchapter V.²²¹

Either way, we are left with massive problems in business bankruptcy. Numerous scholars have criticized the use of bankruptcy by large corporations to evade civil liability for mass torts.²²² In some cases, perpetrators of mass torts file for bankruptcy and shed massive amounts of debt, giving most of the value to secured creditors. In other cases, debtors find ways of keeping value outside the jurisdiction of the bankruptcy court. Some debtors load up a subsidiary with the liability and send it into bankruptcy, a move dubbed the "Texas Two-Step."²²³ Other debtors, like the Sackler family, until recently could send their company (Purdue Pharma) into bankruptcy and ask the bankruptcy court for a release of their own liability in exchange for providing funds to the bankruptcy estate.²²⁴ The Supreme Court has now curtailed such third-party releases, at least without consent of the victims. Applying some discharge exceptions to chapter 11 would give victims a sort of superpriority

²²⁰ See, e.g., Ralph Brubaker, *Taking Exception to the New Corporate Discharge Exceptions*, 13 AM. BANKR. L. REV. 757, 764 (2005) (arguing that the new fraud exceptions in chapter 11 would exacerbate the very holdout problem that chapter 11 is designed to overcome).

²²¹ See HARNER ET AL., *supra* note 217, at 9, 61–67.

²²² See, e.g., JACOBY, *supra* note 219, at 155–200. For a helpful set of differing views on the subject, see Anthony J. Casey & Joshua C. Macey, Essay, *In Defense of Chapter 11 for Mass Torts*, 90 U CHI. L. REV. 973 (2023); 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.F. 525 (2024).

²²³ Michael A. Francus, *Texas Two-Stepping Out of Bankruptcy*, 120 MICH. L. REV. ONLINE 38, 40–41 (2022) (providing a helpful description of this strategy).

²²⁴ See *Harrington v. Purdue Pharma L.P.*, 144 S. Ct. 2071, 2088 (2024). Numerous bankruptcy scholars weighed in on this debate in advance of the Supreme Court's 2024 ruling. For some highlights, see Lindsey D. Simon, *Bankruptcy Grifters*, 131 YALE L.J. 1154, 1183–1202 (2022) (criticizing the use of third-party releases by non-debtor entities); Ralph Brubaker, *Mandatory Aggregation of Mass Tort Litigation in Bankruptcy*, 131 YALE L.J.F. 960, 960–66 (2022) (arguing that the Supreme Court should ban nonconsensual third-party releases).

against assets of the debtor and might prevent some of the worst abuses of the bankruptcy system.

More modest reforms could work better. *Purdue Pharma* removes the possibility that a corporate debtor might “buy” a third-party release that would otherwise be nondischargeable.²²⁵ Some debtors attempt to shed liability by selling the company as a going concern, wiped clean of any debts, to a third-party buyer. But under state law, buyers that take on an entire business can be liable for legacy debt, under doctrines of successor liability or *de facto* merger.²²⁶ Congress (or courts) could clarify that a bankruptcy sale, which empowers the trustee to sell assets of the estate “free and clear of any interest in such property,” does not release the buyer from successor liability, *de facto* merger, or other theories—unless the bankruptcy court takes evidence and determines that the buyer is not a successor under applicable state law.²²⁷ That premise is important for all debts, but particularly for nondischargeable debt. Other initiatives to ban the “Texas Two-Step” are underway in Congress.²²⁸

Whether we reform the law or not, the bankruptcy rules do not mean that defamation (or any other nondischargeable debt) is truly unforgivable. The effect of section 523 is to prevent the debtor from unilaterally invoking bankruptcy’s discharge. In every case where the judge denies a debtor a discharge, some other entity could release the debt: for criminal fines and fees, an executive wielding the pardon

²²⁵ See, e.g., Gross, *supra* note 9, at 506, 518–19 (noting that Harvey Weinstein received discharges in the bankruptcy of his company, Weinstein Co., that he would not have been able to receive had he filed for bankruptcy personally).

²²⁶ See, e.g., *City of Syracuse v. Loomis Armored US, LLC*, 900 F. Supp. 2d 274, 290 (N.D.N.Y. 2012). Texas, by contrast, has abolished successor liability by statute. See TEX. BUS. ORGS. CODE § 10.254(b).

²²⁷ I am not the first to make this connection. Profs. Vincent Buccola and Joshua Macey have argued that if tort claims cannot be given priority status, they should at least be given durable status, allowing them to attach to whichever entity owns the assets after the bankruptcy. See Vincent S.J. Buccola & Joshua C. Macey, *Claim Durability and Bankruptcy’s Tort Problem*, 38 YALE J. ON REG. 766, 766–73 (2021). The problem is that, as Buccola and Macey point out, both bankruptcy plans and section 363 sales cut off tort claimants’ rights against the assets of the company. See *id.* at 786–88.

²²⁸ See, e.g., Evan Ochsner, *Bipartisan Bill Aims to Deter ‘Texas Two-Step’ Bankruptcy Tactic*, BLOOMBERG L. (July 23, 2024, 8:09 PM), <https://perma.cc/VZ7T-WZ2F> (discussing the bipartisan “Ending Texas Two-Step Act”).

power; for taxes and student loans, lawmakers or administrative agencies; for domestic support obligations, a family law judge; and for fraud or willful and malicious injury, the victim. For defamation debt, then, the Code puts the victim in the seat of power. Where appropriate, victims and perpetrators can find a path to reconciliation. Forgiveness remains an open path, just not one that can be ordered by a court.

CONCLUSION

Even without legal reform, we can at least ensure that plaintiffs and defendants alike understand and can reckon with the bankruptcy consequences of defamation cases. Where a claim is likely to be deemed nondischargeable, both parties to the underlying action should be able to litigate (or settle) appropriately. The same rule should obtain where a claim likely can be discharged in bankruptcy. Even though most people don't like to think about it, figuring out some of these answers in advance helps everyone.

We are just starting to grapple with the legal ramifications of the new social media ecosystem, ranging from medical disinformation to revenge porn.²²⁹ When speech injures others, compensation and punishment are in order. Yet forgiveness and a fresh start have their place as well. As to individuals, defamation debt should cause us to reflect on whether our "fresh start" policy in bankruptcy is too anemic. As to business entities, the defamation cases continue to raise the specter of whether chapter 11 makes it too easy for bad actors to shed debt without compensating victims, suffering consequences, or reforming behavior. Either way, attorneys must be prepared to provide forward-thinking legal advice about bankruptcy whenever insolvency is on the horizon.

²²⁹ In a thought-provoking new article, Profs. Leah Fowler, Max Helveston, and Zoë Robinson analyze the role of social media influencers in providing health information and disinformation, arguing that the legal system should impose tort liability for negligent provision of medical advice. See Leah Fowler, Max Helveston & Zoë Robinson, *Influencer Speech-Torts*, 113 GEO. L.J. (forthcoming 2025), <https://papers.ssrn.com/abstract=4933788>.

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United States Court of Appeals, Fifth Circuit.

In the MATTER OF GFS INDUSTRIES, L.L.C. Debtor,
Avion Funding, L.L.C., Appellant,
v.
GFS Industries, L.L.C., Appellee.

No. 23-50237

|

FILED April 17, 2024

Synopsis

Background: Creditor filed adversary complaint, seeking determination that debt owed by “Subchapter V” Chapter 11 debtor, a Texas limited liability company (LLC), was excepted from discharge as a debt for money obtained by a materially false financial statement. Debtor moved to dismiss. The United States Bankruptcy Court for the Western District of Texas, [Craig A. Gargotta](#), Chief Judge, granted debtor's motion, [647 B.R. 337](#), and subsequently granted creditor's motion to certify order for direct appeal, [2023 WL 1768414](#).

[Holding:] Addressing a matter of apparent first impression for the court, the Court of Appeals, [Duncan](#), Circuit Judge, held that in Subchapter V proceedings, both corporate and individual debtors are subject to the list of discharge exceptions set forth in the Bankruptcy Code.

Reversed and remanded.

Procedural Posture(s): On Appeal; Motion to Dismiss for Failure to State a Claim.

West Headnotes (21)

complicate their reorganization. [11 U.S.C.A. §§ 1181 et seq., 1191\(c\)](#).

[2] Bankruptcy  **Debts and Liabilities**
Discharged

Bankruptcy  **Preservation of priority**

Under Subchapter V of Chapter 11 of the Bankruptcy Code, in exchange for the benefit of relieving small business debtors from the absolute priority rule for repaying creditors, those debtors cannot discharge certain “kinds” of debt listed in the section of the Code governing exceptions to discharge. [11 U.S.C.A. §§ 523\(a\), 1181 et seq., 1191\(c\)](#).

[3 Cases that cite this headnote](#)

[3] Contracts  **Loans and advances**

Agreement whereby a financing company gives a business funding in exchange for a specified amount of the business's future receivables is known as a “merchant cash advance.”

[4] Bankruptcy  **Scope of review in general**

When directly reviewing an order of the bankruptcy court, the Court of Appeals applies the same standard of review that would have been used by the district court.

[5] Bankruptcy  **Conclusions of law; de novo review**

Dismissals by a bankruptcy court for failure to state a claim are reviewed de novo. [Fed. R. Civ. P. 12\(b\)\(6\)](#); [Fed. R. Bankr. P. 7012\(b\)](#).

[1] Bankruptcy  **Preservation of priority**

“Subchapter V” seeks to streamline the Chapter 11 reorganization process for certain small business debtors by, inter alia, relieving such debtors from the absolute priority rule for repaying creditors, which was thought to unduly

[6] Bankruptcy  **Effect as discharge**

If a Subchapter V Chapter 11 debtor's bankruptcy plan is confirmed as a consensual plan, the dischargeability of its debts is governed by subsection of the section of the Bankruptcy Code

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governing effect of confirmation of a Chapter 11 plan. 11 U.S.C.A. §§ 1141(d), 1191(a).

[6 Cases that cite this headnote](#)

[1 Case that cites this headnote](#)

[7] **Bankruptcy** — Debts and Liabilities
Discharged

Bankruptcy — Effect as discharge

If a Subchapter V Chapter 11 debtor's plan is confirmed as a nonconsensual plan, the dischargeability of its debts is governed by the section of the Bankruptcy Code governing Subchapter V discharge. 11 U.S.C.A. §§ 1191(b), 1181(c), 1192.

[4 Cases that cite this headnote](#)

[8] **Bankruptcy** — Debts and Liabilities
Discharged

Bankruptcy — Effect as discharge

In proceedings under Subchapter V of Chapter 11, both corporate and individual debtors are subject to list of discharge exceptions set forth in the Bankruptcy Code; although preamble to Code section listing discharge exceptions states that discharge under enumerated sections of Code, including that governing Subchapter V discharge, does not discharge “individual debtor” from any debt, placing controlling weight on word “individual” disregards plain language of the more specific Code section governing Subchapter V discharge, which applies to both individual and corporate debtors and excepts from discharge “any debt” of “kind specified” in Code section listing discharge exceptions, nowhere does Code section governing Subchapter V discharge say “kind of debtor” as might indicate distinction between individual and corporate Subchapter V debtors, and section instead serves as “shorthand” to avoid reiterating all 21 types of debts named in Code section listing discharge exceptions. 11 U.S.C.A. §§ 523(a), 1192, 1192(2).

[9] **Bankruptcy** — Debts and Liabilities
Discharged

Bankruptcy — Effect as discharge

Section of the Bankruptcy Code governing Subchapter V discharge applies to both individual and corporate debtors; it does not distinguish one from the other. 11 U.S.C.A. § 1192.

[3 Cases that cite this headnote](#)

[10] **Bankruptcy** — Construction and Operation

Court must apply the precise language of the Bankruptcy Code as written.

[1 Case that cites this headnote](#)

[11] **Statutes** — General and specific terms and provisions; ejusdem generis

To the extent that one might find tension between two sections of a statute, the more specific provision should govern over the more general.

[2 Cases that cite this headnote](#)

[12] **Statutes** — General and specific terms and provisions; ejusdem generis

The specific/general canon of statutory interpretation is especially applicable where Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions.

[13] **Statutes** — Statute as a Whole; Relation of Parts to Whole and to One Another

If possible, every word and every provision of a statute is to be given effect, and none should be ignored.

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[14] **Statutes** ➡ Superfluosity

In interpreting a statute, the preference for avoiding surplusage constructions is not absolute.

[15] **Statutes** ➡ Relationship to statute amended; clarification or change of meaning

Whether Congress has modified statutory language via a “mere conforming amendment” may be a relevant consideration when court engages in statutory interpretation.

1 Case that cites this headnote

[16] **Bankruptcy** ➡ Dischargeable Debtors

Chapter 7 discharges are available only to individual debtors. 11 U.S.C.A. § 727(a)(1).

1 Case that cites this headnote

[17] **Bankruptcy** ➡ Discharge

Chapter 13 discharges are available only to individual debtors. 11 U.S.C.A. §§ 109(e), 1328(b).

[18] **Constitutional Law** ➡ Particular Issues and Applications

Court construing a section of the Bankruptcy Code cannot add words that Congress did not enact.

[19] **Bankruptcy** ➡ Preservation of priority

In a traditional Chapter 11 case, a nonconsensual plan is subject to the “absolute priority rule,” under which classes of unsecured creditors are fully paid before any junior class. 11 U.S.C.A. § 1129(b)(1), (2)(B)(ii).

[20] **Bankruptcy** ➡ Preservation of priority

Because the Bankruptcy Code places equity holders at the bottom of the priority list, the absolute priority rule may preclude reorganizations in which continuing management of the bankruptcy estate by a business's owners would be essential to a successful reorganization because such owners' retention of estate property would violate the priority rule. 11 U.S.C.A. § 1129(b)(1), (2)(B)(ii).

[21] **Bankruptcy** ➡ Preservation of priority
Bankruptcy ➡ Unsecured creditors and equity holders, protection of

Subchapter V of Chapter 11 abrogates the absolute priority rule for small business debtors, allowing equity owners to retain their interests even though junior creditors are not paid in full; the plan need only ensure that debtor's disposable income is paid to creditors for three to five years. 11 U.S.C.A. § 1191(c), 1191(c)(2)(A), 1191(c)(3).

*225 Appeal from the United States Bankruptcy Court for the Western District of Texas, USBC No. 22-05052, [Craig A. Gargotta](#), Chief Judge

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CDM, Mountain State Justice, National Employment Law Project, North Carolina Justice Center, Workplace Justice Project, Fe y Justicia Worker Center.

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Before Higginbotham, Higginson, and Duncan, Circuit Judges.

Opinion

Stuart Kyle Duncan, Circuit Judge:

[1] [2] In this appeal, we consider a 2019 addition to the Bankruptcy Code known as “Subchapter V,” which seeks to streamline the Chapter 11 reorganization process for certain small business debtors. See 11 U.S.C. § 1181 *et seq.* Subchapter V *226 relieves small business debtors from the absolute priority rule for repaying creditors, which was thought to unduly complicate their reorganization. Compare *id.* § 1129(b)(2) with *id.* § 1191(c). In exchange for that benefit, however, those debtors cannot discharge certain “kinds” of debt listed in § 523(a) of the Code. See *id.* §§ 1192(2), 523(a). The issue we address here is whether those discharge exceptions apply to both corporate and individual Subchapter V debtors (as the Fourth Circuit has ruled) or only to individual debtors (as some bankruptcy courts have ruled). See generally *Cantwell-Cleary Co. v. Cleary Packaging, LLC (In re Cleary Packaging, LLC)*, 36 F.4th 509 (4th Cir. 2022). Although the question is complicated by a certain textual awkwardness in the Bankruptcy Code, we ultimately side with the Fourth Circuit and rule that, in Subchapter V proceedings, both corporate and individual debtors are subject to the list of § 523(a) discharge exceptions.¹

Accordingly, we REVERSE and REMAND.

I.

[3] GFS Industries is a Texas limited liability corporation that provides commercial cleaning services. Seeking financing to expand operations, GFS entered into an agreement with Avion Funding on April 6, 2022. Avion would give GFS \$190,000 in exchange for \$299,800 of GFS's

future receivables.² GFS represented it had not filed, nor did it anticipate filing, any Chapter 11 bankruptcy petition. Nonetheless, on April 21, 2022, two weeks after signing the agreement, GFS petitioned for voluntary Chapter 11 bankruptcy in the Western District of Texas. GFS elected to proceed under Subchapter V, which Congress enacted in 2019 as part of the Small Business Reorganization Act (“SBRA”), Pub. L. No. 116–54, 133 Stat. 1079 (2019).

On July 25, 2022, Avion filed an adversary complaint in GFS's bankruptcy. As relevant here, Avion claimed GFS obtained Avion's financing by misrepresenting whether it anticipated filing for bankruptcy. Avion sought a declaration that GFS's debt to Avion was therefore nondischargeable. In response, GFS moved to dismiss Avion's complaint, arguing that the Bankruptcy Code section on which Avion relied, 11 U.S.C. § 523(a), applies only to individual debtors and that, as a result, GFS's debt was dischargeable.

The bankruptcy court agreed with GFS. It reasoned that “in the Subchapter V context, only individuals, not corporations, can be subject to § 523(a) dischargeability actions.” *Avion Funding, LLC v. GFS Indus., LLC (In re GFS Indus., LLC)*, 647 B.R. 337, 342 (Bankr. W.D. Tex. 2022). In doing so, the court followed the reasoning of four bankruptcy courts.³ It declined to *227 follow the Fourth Circuit's recent decision in *Cantwell-Cleary Co. v. Cleary Packaging, LLC (In re Cleary Packaging, LLC)*, 36 F.4th 509, 517–18 (4th Cir. 2022) [*Cleary*], which held that the Subchapter V discharge exceptions apply to both individual and corporate debtors. Accordingly, the bankruptcy court ruled GFS's debt to Avion was dischargeable and dismissed Avion's complaint. Avion timely appealed to the district court. The bankruptcy court subsequently granted Avion's motion to certify a direct appeal to our court under 28 U.S.C. § 158(d)(2). *Avion Funding, LLC v. GFS Indus., LLC (In re GFS Indus., LLC)*, 2023 WL 1768414, at *4 (Bankr. W.D. Tex. Feb. 3, 2023).

II.

[4] [5] “When directly reviewing an order of the bankruptcy court, we apply the same standard of review that would have been used by the district court.” *Drive Fin. Servs., L.P. v. Jordan*, 521 F.3d 343, 346 (5th Cir. 2008). Dismissals under Rule 12(b)(6) for failure to state a claim are reviewed

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de novo. See *Norsworthy v. Hous. Indep. Sch. Dist.*, 70 F.4th 332, 336 (5th Cir. 2023).

III.

[6] [7] GFS proceeds under Subchapter V, enacted in 2019 to streamline Chapter 11 reorganizations for small business debtors whose debt does not exceed \$7.5 million. See 11 U.S.C. § 1181 *et seq.*; *id.* § 1182(1); see also *In re Free Speech Sys., LLC*, 649 B.R. 729, 735 (Bankr. S.D. Tex. 2023) (“Subchapter V only applies when a debtor elects to proceed under it.” (citing 11 U.S.C. § 103(i))). If a debtor’s bankruptcy plan is confirmed as a consensual plan under § 1191(a), the dischargeability of its debts is governed by § 1141(d). See 11 U.S.C. § 1181(a) (only § 1141(d)(5) concerning individual debtors is inapplicable to Subchapter V consensual plan discharge provisions). By contrast, GFS’s plan was confirmed as a nonconsensual plan under § 1191(b), so the dischargeability of its debts is governed by § 1192. See *id.* § 1181(c) (“If a plan is confirmed under section 1191(b) of this title, section 1141(d) of this title shall not apply, except as provided in section 1192 of this title.”).

As § 1192 provides, after the debtor completes the required payments, the bankruptcy court

shall grant the debtor a discharge of all debts provided in section 1141(d)(1)(A)⁴ of this title, and all other debts allowed under section 503 of this title and provided for in the plan, *except any debt--*

(1) on which the last payment is due after the first 3 years of the plan, or such other time not to exceed 5 years fixed by the court; or

(2) of the kind specified in section 523(a) of this title.

Id. § 1192 (emphasis added). The cross-referenced § 523(a) lists various types of non-dischargeable debts—for instance, debts for certain “tax or customs [] dut[ies],” for “domestic support obligation[s],” or for failing “to pay fines or penalties imposed under Federal election *228 law.” See *id.* § 523(a) (1), (5), (14B). The category relevant here is a debt for money obtained by a “materially false” written statement “respecting the debtor’s ... financial condition.” *Id.* § 523(a)(2)(B)(i)–(ii).

[8] The textual conundrum in this case arises from § 523(a)’s preamble: “A discharge under section 727, 1141, 1192, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt” *Id.* § 523(a) (emphasis added). In ruling for GFS, the bankruptcy court deemed this preamble “critical to the analysis.” Specifically, the court reasoned that § 523(a)’s “limiting language” means that, in a Subchapter V proceeding, the listed non-dischargeability exceptions apply only to an “individual debtor.” But they do not apply to a limited liability company like GFS—meaning its debt to Avion, even if procured by misrepresenting its financial condition, could still be dischargeable. On appeal, Avion contests the bankruptcy court’s understanding of the interplay between § 523(a) and § 1192(2). We consider each of its arguments in turn.

A.

Avion argues that placing controlling weight on the word “individual” in § 523(a) disregards the plain language of § 1192(2). We agree.

[9] To begin with, § 1192 governs discharging debts of a “debtor,” plain and simple. See 11 U.S.C. § 1192 (requiring court to “grant the debtor a discharge” of all specified debts (emphasis added)). A Subchapter V “debtor” means “a person engaged in commercial or business activities” with debts not exceeding \$7.5 million. *Id.* § 1182(1)(A). “[P]erson” is in turn defined to include both individuals and corporations, see *id.* § 101(41), and “corporation[s]” include limited liability companies, *id.* § 101(9)(A).⁵ *Cleary*, 36 F.4th at 514 (citations omitted). So, putting all this together, § 1192 applies to both individual and corporate debtors. *Id.* at 514–15. It does not distinguish one from the other.

[10] Next, § 1192 excepts from discharge “any debt ... of the kind specified in section 523(a).” 11 U.S.C. § 1192(2) (emphasis added). We must apply this precise language as written. See *Ransom v. FIA Card Servs., N.A.*, 562 U.S. 61, 69, 131 S.Ct. 716, 178 L.Ed.2d 603 (2011) (“[I]nterpretation of the Bankruptcy Code starts ... with the language of the statute itself.” (quotation marks and citation omitted)). Section 523(a) enumerates 21 categories or “kinds”⁵ of non-dischargeable debts. See § 523(a)(1)–(20) (including (14), (14A), and (14B)). So, the most natural reading of § 1192(2)

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is that it subjects both corporate and individual Subchapter V debtors to the categories of debt discharge exceptions listed in § 523(a). See *Cleary*, 36 F.4th at 515 (“[T]he combination of the terms ‘debt’ and ‘of the kind’ indicates that Congress intended to reference only the *list of non-dischargeable debts* found in § 523(a).”).

Consider, moreover, what § 1192(2) does not say: “kind of debtor.” Congress could have enacted those words in § 1192 but instead chose “kind of debt.” That text cannot be read to incorporate a distinction between “individual” and “corporate” debtors. Rather, as the Fourth Circuit correctly reasoned, the reference to “kind[s]” of debt in § 1192 serves as “a shorthand to avoid listing all 21 types of debts” in § 523(a), “which would indeed have expanded the one-page section to add several *229 additional pages to the U.S. Code.” *Cleary*, 36 F.4th at 515.

[11] [12] In addition, to the extent §§ 523(a) and 1192(2) clash, § 1192(2) governs as the more specific provision. Section 1192 deals directly with Subchapter V discharges, whereas § 523(a) cuts across various Bankruptcy Code provisions. See § 523(a) (listing “section 727, 1141, 1192, 1228(a), 1228(b), or 1328(b) of this title”). As the Fourth Circuit observed, “to the extent that one might find tension” between the two sections, “the more specific provision should govern over the more general.” *Cleary*, 36 F.4th at 515; see also, e.g., *RadLAX Gateway Hotel, L.L.C. v. Amalgamated Bank*, 566 U.S. 639, 645, 132 S.Ct. 2065, 182 L.Ed.2d 967 (2012) (observing “[i]t is a commonplace of statutory construction that the specific governs the general” and applying the canon to the Bankruptcy Code (quoting *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384, 112 S.Ct. 2031, 119 L.Ed.2d 157 (1992))). The specific/general canon is especially applicable where “Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions.” *RadLAX*, 566 U.S. at 645, 132 S.Ct. 2065 (citation omitted); see also ANTONIN SCALIA & BRYAN A. GARNER, *READING LAW: THE INTERPRETATION OF LEGAL TEXTS* 185 (2012) (“The specific provision does not negate the general one entirely, but only in its application to the situation that the specific provision covers.”). Subchapter V fits that bill: it legislates specific reorganization options for small business debtors.

[13] [14] GFS counters (echoing the bankruptcy court) that this interpretation of § 1192(2) makes the word “individual”

in § 523(a) superfluous. See 11 U.S.C. § 523(a) (“A discharge under section ... 1192 ... of this title does not discharge an individual debtor ...”) (emphasis added)). This argument has some force because, “[i]f possible, every word and every provision [of a statute] is to be given effect,” and “none should be ignored.” Scalia & Garner, *supra*, at 174. At the same time, though, the “preference for avoiding surplusage constructions is not absolute.” *Lamie v. U.S. Tr.*, 540 U.S. 526, 536, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004); see also *Chickasaw Nation v. United States*, 534 U.S. 84, 94, 122 S.Ct. 528, 151 L.Ed.2d 474 (2001) (noting “[t]he canon requiring a court to give effect to each word ‘if possible’ is sometimes offset by the canon that permits a court to reject words ‘as surplusage’ if ‘inadvertently inserted or if repugnant to the rest of the statute’ ” (citation omitted)).

[15] We agree with *amicus curiae* United States that the anti-surplusage canon does not win the day here. To begin with, the reference to § 1192 was added to § 523(a) via a “conforming amendment.” See Br. of *Amicus Curiae* United States at 21 (citing H.R. Rep. No. 116-171, at 9 (2019)); see also Pub. L. No. 116-54, 133 Stat. 1079, 1085-86 (2019). That would be an awkward way of modifying § 1192(2)’s straightforward “kind of debt” language. See *Cyan, Inc. v. Beaver Cnty. Emps. Ret. Fund*, 583 U.S. 416, 431, 138 S.Ct. 1061, 200 L.Ed.2d 332 (2018) (“Congress does not make ‘radical—but entirely implicit—change[s]’ through ‘technical and conforming amendments.’ ” (quoting *Dir. of Revenue of Mo. v. CoBank ACB*, 531 U.S. 316, 324 (2001))). In other words, it would be no “minor tweak” to § 1192(2), *id.* at 430, 138 S.Ct. 1061, to change “kind of debt” to “kind of debtor.” It is unlikely Congress would have done such a thing through a cross-reference in a “mere conforming amendment.” *Ibid.* (cleaned up).

[16] [17] This interpretation gains traction when we examine other statutory *230 cross-references in § 523(a)’s preamble. Some are themselves superfluous. For example, § 523(a) refers to § 727 even though Chapter 7 discharges are already available only to individual debtors. See 11 U.S.C. § 727(a)(1). So, the term “individual” as applied to § 727 is entirely redundant. See *id.* § 727(b). The same applies to § 523(a)’s reference to § 1328(b): Chapter 13 discharges are also available only to individual debtors. See *id.* §§ 109(e), 1328(b).

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Other problems emerge when we consider § 523(a)'s cross-reference to § 1141. Part of that section, § 1141(d)(6), provides that traditional Chapter 11 discharges will not discharge a corporate debtor from certain kinds of debts in § 523(a). *See id.* § 1141(d)(6)(A) (providing “a debtor that is a corporation” is not discharged from debts “of a kind specified in paragraph (2)(A) or (2)(B) of section 523(a)”). But if we read “individual” in § 523(a)'s preface to control all the cross-referenced statutes, that would erase the corporate debtor discharge exceptions in § 1141(d)(6). *See Cleary*, 36 F.4th at 516 (observing that this interpretation “would ... create difficulty in reconciling § 523(a) with § 1141(d)(6)”). This is yet another reason not to read the word “individual” in § 523(a) to implicitly modify § 1192(2).

B.

Avion's argument gains greater force when we situate § 1192 in the larger context of the Bankruptcy Code. *See, e.g., In re Lively*, 717 F.3d 406, 409 (5th Cir. 2013) (reading “the language of the statute taken in the context of the Bankruptcy Code of which it is a part” (citing *RadLAX*, 132 S. Ct. at 2070–71)). Other Code provisions explicitly limit discharges to “individual” debtors.⁶ Even traditional Chapter 11 proceedings distinguish discharges for individual and corporate debtors.⁷

[18] By contrast, § 1192 provides dischargeability simply for “the debtor”—which, as noted, the Code defines as encompassing both individual and corporate debtors. *See also Cleary*, 36 F.4th at 515–16 (distinguishing § 1192 from other provisions that “conscientiously defined and distinguished the kinds of debtors covered”). We cannot add words to § 1192 that Congress did not enact. *See Russello v. United States*, 464 U.S. 16, 23, 104 S.Ct. 296, 78 L.Ed.2d 17 (1983) (“[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.” (quoting *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir. 1972))).

Avion also draws our attention to the Chapter 12 discharge provision, covering family farmers or fishermen, which is virtually identical to § 1192. *See* 11 U.S.C. § 1228(a).

Chapter 12 allows “the debtor” a discharge of all specified debts “except any debt ... of a kind specified in section 523(a) of this title.” *Ibid.* (emphasis added). As the Fourth Circuit recognized, “courts construing the scope of § 1228(a) have concluded that [its] discharge exceptions apply to both individual debtors and corporate debtors.” *Cleary*, 36 F.4th at 516 (citing *231 *Sw. Ga. Farm Credit, Aca v. Breezy Ridge Farms, Inc. (In re Breezy Ridge Farms, Inc.)*, 2009 WL 1514671, at *1–2 (Bankr. M.D. Ga. May 29, 2009); *New Venture P'ship v. JRB Consol., Inc. (In re JRB Consol., Inc.)*, 188 B.R. 373, 374 (Bankr. W.D. Tex. 1995)).

In particular, the *JRB Consolidated* bankruptcy court reasoned that “[t]he wording in § 1228(a)(2) describing ‘debts of the kind’ specified in § 523(a) does not naturally lend itself to incorporate the meaning ‘for debtors of the kind’ referenced in § 523(a).” 188 B.R. at 374 (emphasis added).⁸ We see no reason why this sound analysis of § 1228(a)'s text would not apply equally to the substantively identical phrase in § 1192(2). *Accord Cleary*, 36 F.4th at 517 (“[I]dential words and phrases within the same statute should normally be given the same meaning.” (quoting *Hall v. United States*, 566 U.S. 506, 519, 132 S.Ct. 1882, 182 L.Ed.2d 840 (2012))). Moreover, § 1228(a) is also referenced in § 523(a)'s preamble along with § 1192. *See* § 523(a) (referencing “[a] discharge under section ... 1192 [and] 1228(a)”). So, if we adopted the restrictive reading of § 1192 urged by GFS, it would undermine bankruptcy courts' interpretation of § 1228(a). *Accord Cleary*, 36 F.4th at 516. We decline to do so.⁹

C.

Finally, GFS contends that our interpretation of § 1192 will frustrate Congress's purposes in enacting Subchapter V. We disagree.

First of all, GFS's argument relies on vague assertions in the SBRA's legislative history. But the history GFS cites does not speak to, or even mention, the individual-vs-corporate debtor issue before us. GFS merely quotes a committee report's statement that Subchapter V sought to “streamline the bankruptcy process” for “small business debtors.”¹⁰ Even if one were inclined to consult legislative history, such generalities are no help in resolving the concrete interpretive issue we address today. *See Food Mktg. Inst. v. Argus Leader*

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Media, 588 U.S. 427, 139 S. Ct. 2356, 2364, 204 L.Ed.2d 742 (2019) (noting the Supreme Court “has repeatedly refused to alter” statute’s “plain terms on the strength only of arguments from legislative history”); *Hubbard v. United States*, 514 U.S. 695, 708, 115 S.Ct. 1754, 131 L.Ed.2d 779 (1995) (“Courts should not rely on inconclusive statutory history as a *232 basis for refusing to give effect to the plain language of an Act of Congress[.]”).

[19] [20] Second, and more importantly, GFS misunderstands the compromises Congress made in Subchapter V. In a traditional Chapter 11 case, a nonconsensual plan is subject to the “absolute priority rule,” under which classes of unsecured creditors are fully paid before any junior class. See *In re Lively*, 717 F.3d 406, 410 (5th Cir. 2013); see also *In re Pac. Lumber Co.*, 584 F.3d 229, 244 (5th Cir. 2009); 11 U.S.C. § 1129(b)(1), (2)(B)(ii). Because “the Code places equity holders at the bottom of the priority list,” *Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 457, 137 S.Ct. 973, 197 L.Ed.2d 398 (2017), however, the absolute priority rule “could preclude reorganizations in which continuing management of the bankruptcy estate by a business’s owners would be essential to a successful reorganization because such owners’ retention of estate property would violate the priority rule.” *Cleary*, 36 F.4th at 514.

[21] In the SBRA, Congress sought to help small business debtors by abrogating the absolute priority rule, allowing equity owners to retain their interests even though junior creditors are not paid in full. See 11 U.S.C. § 1191(c). The plan needs only ensure that the debtor’s disposable income be paid to creditors for three to five years. *Cleary*, 36 F.4th

at 514 (citing *id.* § 1191(c)(2)(A) and (3)). Congress did not stop there, though. To counterbalance that benefit to debtors, Congress excepted from discharge “any debt ... of the kind specified in section 523(a).” *Id.* § 1192(2). In other words, like most legislation, Subchapter V is a compromise: affording small business debtors unique benefits while subjecting them to § 523(a)’s dischargeability exceptions. See *Cleary*, 36 F.4th at 517 (“Given the elimination of the absolute priority rule, Congress understandably applied limitations on the discharge of debts to provide an additional layer of fairness and equity to creditors to balance against the altered order of priority that favors the debtor.”).

To agree with GFS’s argument here would be to rewrite that compromise—at least insofar as small business corporate debtors are concerned—in the face of § 1192(2)’s plain language and context. We have no authority to do so, especially based on statements in legislative history that Congress never enacted in the statute.¹¹

IV.

In sum, we agree with the Fourth Circuit that 11 U.S.C. § 1192(2) subjects both corporate and individual Subchapter V debtors to the categories of debt discharge exceptions listed in § 523(a). Accordingly, the judgment of the bankruptcy court is REVERSED and REMANDED for further proceedings consistent with this opinion.

All Citations

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Footnotes

- 1 To be sure, the issue is a close and interesting one—as shown by the fact that it was recently the subject of a national bankruptcy moot court competition. See Paul R. Hage & G. Ray Warner, *31st Annual Conrad B. Duberstein National Bankruptcy Moot Court Competition*, 32 NORTON J. BANKR. L. & PRAC. art. 1 (Feb. 2023).
- 2 Such an agreement is known as a “Merchant Cash Advance.”

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- 3 See *Jennings v. Lapeer Aviation, Inc.* (*In re Lapeer Aviation, Inc.*), 2022 WL 1110072 (Bankr. E.D. Mich. Apr. 13, 2022) (ruling that corporate debtors proceeding under Subchapter V are not subject to § 523(a) actions); *Catt v. Rtech Fabrications, LLC* (*In re Rtech Fabrications, LLC*), 635 B.R. 559, 568 (Bankr. D. Idaho 2021) (same); *Cantwell-Cleary Co. v. Cleary Packaging, LLC* (*In re Cleary Packaging, LLC*), 630 B.R. 466, 468 (Bankr. D. Md. 2021), *rev'd* 36 F.4th 509 (4th Cir. 2022) (same); *In re Satellite Rests. Inc. Crabcake Factory USA*, 626 B.R. 871, 873 (Bankr. D. Md. 2021) (same). In July 2023, a bankruptcy appellate panel of the Ninth Circuit arrived at the same conclusion. See generally *Lafferty v. Off-Spec Sols., LLC* (*In re Off-Spec Sols., LLC*), 651 B.R. 862 (B.A.P. 9th Cir. 2023). In addition, some leading bankruptcy scholars agree with these authorities. See generally Paul W. Bonapfel & Robert Schaaf, *Do § 523(a) Exceptions to Discharge Apply to the Discharge of a Corporation in a Subchapter V Case After “Cramdown” Confirmation Under § 1191(b)?*, 32 NORTON J. BANKR. L. & PRAC. art. 1 (Dec. 2023); Richard P. Cook, *Discharges in Subchapter V*, 41 AM. BANKR. INST. J. 24 (2022).
- 4 This subpart refers, as relevant here, to “any debt that arose before the date of such [plan] confirmation.” 11 U.S.C. § 1141(d)(1)(A).
- 5 See, e.g., *Kind*, MERRIAM-WEBSTER DICTIONARY, <https://www.merriam-webster.com/dictionary/kind> [<https://perma.cc/QBX6-ZB94>] (last visited Mar. 19, 2024) (“[A] group united by common traits or interests: CATEGORY.”); *Kind*, CAMBRIDGE DICTIONARY (4th ed. 2013) (“[A] group with similar characteristics, or a particular type.”).
- 6 See 11 U.S.C. § 727(a)(1) (in Chapter 7 proceedings, “[t]he court shall grant the debtor a discharge, unless ... the debtor is not an individual”); *id.* § 109(e) (“Only an individual with regular income ... may be a debtor under chapter 13 of this title.”).
- 7 *Id.* § 1141(d)(2) (denying § 523 dischargeability for a “debtor who is an individual”); *id.* § 1141(d)(5) (limiting dischargeability when “the debtor is an individual”); *id.* § 1141(d)(6) (same for “a debtor that is a corporation”).
- 8 See also *Breezy Ridge Farms*, 2009 WL 1514671, at *2 (explaining that, “[a]lthough 523(a) applies only to individuals, Congress has used it as shorthand to define the scope of a Chapter 12 discharge for corporations as well as individuals”).
- 9 Like the bankruptcy court, GFS would distinguish *JRB Consolidated* on the ground that Chapter 11’s discharge provisions are “narrower” than Chapter 12’s. That may have been an accurate statement in 1995, when *JRB Consolidated* was decided. But in 2005 Congress broadened Chapter 11’s discharge exception provisions such that corporate debtors are now subject to dischargeability complaints under § 1141(d)(6). See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S. 256, 109th Cong. § 708 (2005); Pub. L. No. 109-8, 119 Stat. 23, 126–27 (2005) (adding 11 U.S.C. § 1141(d)(6)). Accordingly, like the Fourth Circuit, we fail to see any relevant difference in scope between the Chapter 11 and 12 discharge provisions. See *Cleary*, 36 F.4th at 516–17.
- 10 *Amicus curiae* National Association of Bankruptcy Trustees (“NABT”) similarly relies on one vague assertion from the legislative history that § 1192(2) pertains only to debt “that is otherwise nondischargeable.” See H.R. Rep. No. 116-171, at 8 (2019). At the same time, NABT concedes that in 72 pages of legislative history, discussion of § 523(a) “appears only once.” Accordingly, this one isolated reference does not outweigh the evidence from the statutory texts enacted by Congress. See *Azar v. Allina Health Servs.*, 587 U.S. 566, 139 S. Ct. 1804, 1814, 204 L.Ed.2d 139 (2019) (explaining that “legislative history is not the law”).

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- 11 *Amicus* NABT worries that subjecting corporate debtors to § 523(a)'s exceptions will frustrate Subchapter V's efficiency goals by, for instance, incentivizing creditors to promiscuously file § 523(a) complaints against debtors. But these arguments are grounded in policy considerations, not statutory text or structure. And, in any event, the Bankruptcy Code already provides remedies for abusive complaints. See *FED. R. BANKR. P. 9011(c) (sanctions)*.

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In re Financial Oversight and Management Board for Puerto Rico, 121 F.4th 280 (2024)

121 F.4th 280
United States Court of Appeals, First Circuit.

IN RE: The FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO, as Representative for the Commonwealth of Puerto Rico; The Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Sales Tax Financing Corporation, aka [COFINA](#); The Financial Oversight and Management Board for Puerto Rico, as Representative for the Employees Retirement System of the Government of the Commonwealth of Puerto Rico; The Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Highways and Transportation Authority; The Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Electric Power Authority (PREPA); The Financial Oversight and Management Board for Puerto Rico, as Representative of the Puerto Rico Public Buildings Authority, Debtors, The Financial Oversight and Management Board for Puerto Rico, as Representative of the Puerto Rico Electric Power Authority; Puerto Rico Fiscal Agency and Financial Advisory Authority; The Official Committee of Unsecured Creditors of All Title III Debtors, Plaintiffs-Appellees/Cross-Appellants, Cortland Capital Market Services LLC, as Administrative Agent; Sola Ltd.; [Solus Opportunities Fund 5 LP](#); Ultra Master Ltd; [Ultra NB LLC](#); Union de Trabajadores de la Industria Electrica y Riego Inc. (UTIER); Sistema de Retiro de los Empleados de la Autoridad de Energia Electrica (SREAEE), Plaintiffs-Appellees, v.

U.S. Bank National Association, as Trustee; [Assured Guaranty Corp.](#); Assured Guaranty Municipal Corp.; GoldenTree Asset Management LP; Syncora Guarantee, Inc.; [Alliance Bernstein L.P.](#); Aristeia Capital, L.L.C.; Capital Research and Management Company; Columbia Management Investment Advisors, LLC; Delaware Management Company, a Series of Macquarie Investment Management Business Trust to the Form 2019; Ellington Management Group, L.L.C.; Goldman Sachs Asset Management L.P.; Invesco Advisers, Inc.; Mackay Shields LLC; Massachusetts Financial Services Company; Russell Investment Company, on Behalf of Russell Investment Company Tax-Exempt High Yield Bond Fund; [SIG Structured Products, LLC](#); [T Rowe Price](#); Tower Bay Asset Management, Defendants-Appellants/Cross-Appellees,

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I
November 13, 2024

Synopsis

Background: Financial Oversight and Management Board for Puerto Rico filed adversary complaint seeking, inter alia, disallowance of proof of claim filed by parties holding certain revenue bonds that had been issued by the Puerto Rico Electric Power Authority (PREPA) before it entered reorganization proceedings under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA). Bondholders counterclaimed for declaratory judgment. Numerous entities were allowed to intervene. The United States District Court for the District of Puerto Rico, [Laura Taylor Swain, J.](#), sitting by designation, granted in part and denied in part the parties' cross-motions for summary judgment, [649 B.R. 381](#), and subsequently granted Board's motion to dismiss remaining counts of bondholders' counterclaim complaint, [2023 WL 8244056](#). Bondholders appealed, Board and associated entities cross-appealed, and appeals were consolidated.

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

[1] under Puerto Rico law, preamble of trust agreement under which revenue bonds were issued was not merely prefatory but, instead, was a granting clause;

[2] trust agreement granted bondholders a lien on PREPA's "net revenues," not on its gross revenues;

[3] bondholders' lien on PREPA's net revenues applied to future net revenues;

[4] bondholders' lien was perfected with respect to net revenues that PREPA had acquired, and so lien could not be avoided by the Board using its powers as hypothetical judgment lien creditor;

[5] proper amount of bondholders' allowed claim was face value of revenue bonds, that is, principal plus matured interest, or roughly \$8.5 billion;

[6] bondholders were nonrecourse creditors and, thus, if their collateral only satisfied part of their claim, they could not file deficiency claim for the remainder;

[7] PREPA was not itself a trustee with respect to all moneys received and, thus, the Title III court properly dismissed bondholders' breach-of-trust claim; but

[8] bondholders properly pled a claim for an equitable accounting.

Affirmed in part and reversed in part.

Opinion, [104 F.4th 367](#), withdrawn.

Procedural Posture(s): On Appeal; Motion for Summary Judgment; Request for Declaratory Judgment; Objection to Proof of Claim; Motion to Dismiss for Failure to State a Claim.

West Headnotes (48)

[1] Territories Actions by or against territories

Under the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), the Financial Oversight and Management Board for Puerto Rico is empowered to place Commonwealth entities into "Title III" bankruptcy-type restructuring proceedings, which resemble municipal bankruptcy proceedings under Chapter 9 of the Bankruptcy Code. [48 U.S.C.A. §§ 2121\(b\)\(1\), 2161\(a\)](#).

[2] Territories Actions by or against territories

Bondholders' ability to pursue any remedies against the Puerto Rico Electric Power Authority (PREPA) under Commonwealth law was automatically stayed when the Financial Oversight and Management Board for Puerto Rico commenced a Title III proceeding in district court to restructure PREPA pursuant to the Puerto Rico Oversight, Management,

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and Economic Stability Act (PROMESA). 11
U.S.C.A. § 362(a); 48 U.S.C.A. § 2161(a).

[More cases on this issue](#)

[3] **Electricity** 🗝️ Regulation in general; statutes and ordinances

Under Puerto Rico law, preamble to trust agreement under which Puerto Rico Electric Power Authority (PREPA) issued revenue bonds was not merely a non-binding prefatory clause but, instead, was an operative lien-granting clause; although agreement began with table-setting “whereas” clauses, subsequent “Now, Therefore” clause stated that, in order to secure payment of revenue bonds, PREPA “[did] hereby pledge” to trustee the revenues of its system and other specified moneys, that language reflected a grant, not merely an aspiration or a description of background facts, and evinced an intent to create a security interest, and Commonwealth's Authority Act, which authorized PREPA to grant liens in its revenues, used same phrasing as preamble and thus expressly contemplated that “pledge” to “secure payment” of bond could create security interest. 22 L.P.R.A. § 206(e)(1).

[More cases on this issue](#)

[4] **Contracts** 🗝️ Agreement to make contract in future; negotiations in general

Contract language that only expresses aspirations of parties, such as classic “whereas” clause, can be mere table-setter, often without legal force.

[5] **Secured Transactions** 🗝️ Necessity and sufficiency of writing in general

There is no “magic words” requirement for creating a security interest under Puerto Rico law; instead, a security agreement need only indicate an objective intent to create a security interest.

[6] **Territories** 🗝️ Actions by or against territories

Under Puerto Rico law, trust agreement under which Puerto Rico Electric Power Authority (PREPA) issued revenue bonds granted bondholders a lien on PREPA's net revenues, not on its gross revenues; although agreement did not define “revenues of the System” at issue, its “opinion of counsel” clause, which parties drafted to direct future counsel on how to describe collateral securing revenue bonds in connection with issuance and delivery of any such bonds, stated that agreement “create[d] a legally valid and effective pledge of the Net Revenues” and of “moneys, securities, and funds held or set aside” under agreement as security for bonds, nowhere did agreement state that bondholders' lien was secured by all of PREPA's revenues, and so agreement, read as a whole, clearly provided that “revenues of the System” meant “Net Revenues,” that is, gross revenues minus current expenses.

[More cases on this issue](#)

[7] **Contracts** 🗝️ Construction as a whole

Under Puerto Rico law, court should read a contract “as a whole.”

[8] **Electricity** 🗝️ Regulation in general; statutes and ordinances

In determining scope of lien created, did focused description of collateral in “opinion of counsel clause” control? **Yes**

Under Puerto Rico law, in determining scope of lien created by trust agreement under which Puerto Rico Electric Power Authority (PREPA) issued particular revenue bonds, agreement's driveby references to “Revenues” had to take a back seat to drafters' focused description of the collateral in agreement's “opinion of counsel clause.” [Restatement \(Second\) of Contracts § 203](#).

[More cases on this issue](#)

[9] **Bankruptcy** 🗝️ [Adjustment of Debts of a Municipality](#)

Under the Bankruptcy Code, any lien on a Chapter 9 debtor-utility's "special revenues" is subordinate to the debtor's reasonable and necessary postpetition operating expenses. 11 U.S.C.A. § 928(b).

[10] **Electricity** 🗝️ [Regulation in general; statutes and ordinances](#)

Under Puerto Rico law, trust agreement under which Puerto Rico Electric Power Authority (PREPA) issued revenue bonds granted bondholders a lien on PREPA's net revenues, even if they were not placed in specified funds created by agreement; agreement's preamble stated in relevant part that PREPA pledged to trustee "the revenues of the System . . . and other moneys to the extent provided in [the] Agreement . . . as follows," and although more specific grants within agreement expressly provided for liens in certain "sinking" and "subordinate" funds, agreement's "opinion of counsel" clause drew clear grammatical distinction between PREPA's pledge of "Net Revenues" and its pledge of "moneys, securities, and funds held or set aside" under agreement, such that preamble's modifying phrase "to the extent provided" applied only to "other moneys," not to "revenues of the System," and agreement's pledge of net revenues was not limited to those deposited in sinking and subordinate funds.

[More cases on this issue](#)

[11] **Statutes** 🗝️ [Relative and qualifying terms and provisions, and their relation to antecedents](#)

Under one canon of statutory interpretation, when several words are followed by a clause which is applicable as much to the first and other

words as to the last, the natural construction of the language demands that the clause be read as applicable to all.

[12] **Statutes** 🗝️ [Relative and qualifying terms and provisions, and their relation to antecedents](#)

Canon of statutory interpretation known as "canon of the last antecedent" broadly prescribes that a limiting clause or phrase should ordinarily be read as modifying only the noun or phrase that it immediately follows.

[13] **Electricity** 🗝️ [Regulation in general; statutes and ordinances](#)

In determining scope of bondholders' security interest, mere fact that court construed text of trust agreement governing Puerto Rico Electric Power Authority's (PREPA) issuance of revenue bonds as granting an arguably superfluous lien was not enough to invalidate the agreement; superfluity was hardly unheard of in revenue bond agreements. [Restatement \(Second\) of Contracts § 203](#).

[More cases on this issue](#)

[14] **Territories** 🗝️ [Actions by or against territories](#)

Under Puerto Rico law, trust agreement under which Puerto Rico Electric Power Authority (PREPA) issued revenue bonds, which granted bondholders a lien on PREPA's net revenues, also granted a lien on the utility's future net revenues; Commonwealth law permitted bondholders to hold a security interest in yet-to-be-acquired net revenues, and the Bankruptcy Code, as incorporated by the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), which governed PREPA's Title III restructuring proceeding, made clear that a lien on "special revenues" like those at issue in the case continued to attach to revenues acquired postpetition. 11 U.S.C.A. § 928(a); 48 U.S.C.A.

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§ 2161(a); 19 L.P.R.A. § 2234(a); 22 L.P.R.A. § 206(e)(1).

[More cases on this issue](#)

[15] **Territories** 🗝️ [Actions by or against territories](#)

Puerto Rico law determines whether, and to what extent, a trustee or bondholder may have security interest in assets of bankrupt borrower, in reorganization proceedings under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA). 48 U.S.C.A. §§ 2161-2178.

[16] **Secured Transactions** 🗝️ [After-acquired property](#)

Puerto Rico's version of the Uniform Commercial Code (UCC) sanctions security interests in after-acquired collateral, i.e., liens extending to property that the debtor does not possess at the time of the underlying security agreement, which are also known as "floating liens." 19 L.P.R.A. § 2234(a); U.C.C. § 9-204.

[17] **Bankruptcy** 🗝️ [Adjustment of Debts of a Municipality](#)

Congress has recognized, in the Bankruptcy Code, that a revenue bond can be secured by future income. 11 U.S.C.A. § 928.

[18] **Bankruptcy** 🗝️ [Post-petition effect](#)

Under the Bankruptcy Code, a lien on after-acquired property generally does not attach to property acquired after the debtor files for bankruptcy. 11 U.S.C.A. § 552(a).

[19] **Bankruptcy** 🗝️ [Post-petition effect](#)
Bankruptcy 🗝️ [Adjustment of Debts of a Municipality](#)

Under the Bankruptcy Code, a lien on "special revenues" continues to attach to revenues acquired by a Chapter 9 debtor postpetition, notwithstanding the Code's general bar on liens on property acquired after the debtor files for bankruptcy. 11 U.S.C.A. §§ 552(a), 928(a).

[20] **Bankruptcy** 🗝️ [Post-petition effect](#)
Bankruptcy 🗝️ [Adjustment of Debts of a Municipality](#)

Congress passed the section of the Bankruptcy Code governing Chapter 9 debtors' pledges of special revenue to alleviate the concern that municipalities would use the Code provision generally barring liens on property acquired postpetition to avoid long-term pledges of project-specific revenues. 11 U.S.C.A. §§ 552(a), 928.

[21] **Bankruptcy** 🗝️ [Post-petition effect](#)
Bankruptcy 🗝️ [Adjustment of Debts of a Municipality](#)

Bankruptcy Code not only recognizes that a Chapter 9 debtor may grant a lien on future revenues -- it also expressly states that such liens continue to attach to revenues acquired after the filing of a bankruptcy petition. 11 U.S.C.A. § 928.

[22] **Bankruptcy** 🗝️ [Post-petition effect](#)

Broadly, under the Bankruptcy Code, a creditor maintains a postpetition lien on the "proceeds" of collateral acquired prepetition. 11 U.S.C.A. § 552(b)(1).

[23] **Secured Transactions** 🗝️ [Property Included](#)
Secured Transactions 🗝️ [Title and interests in collateral](#)

Under Puerto Rico's version of the Uniform Commercial Code (UCC), a security interest

generally cannot attach to property until (1) the property exists, and (2) the debtor has a transferable right in that property. 19 L.P.R.A. §§ 2233(a), 2233(b); U.C.C. § 9-204.

[24] **Electricity** 📌 Regulation in general; statutes and ordinances

Was granting of floating lien in future net revenues permitted? **Yes**

Under Puerto Rico law, even though floating lien in future net revenues granted to bondholders by trust agreement under which Puerto Rico Electric Power Authority (PREPA) issued revenue bonds did not permit bondholders to demand present payment of net revenues that PREPA would receive in five years, that did not mean that PREPA could not convey an initial overarching interest in any net revenues that would come through the door in five years. 19 L.P.R.A. § 2234(a); 22 L.P.R.A. § 206(e)(1); U.C.C. § 9-204.

[More cases on this issue](#)

[25] **Secured Transactions** 📌 After-acquired property

Under Puerto Rico's version of the Uniform Commercial Code (UCC), a creditor cannot enforce a floating lien with respect to specific units of yet-to-be-acquired collateral. 19 L.P.R.A. §§ 2233(a), 2233(b); U.C.C. § 9-204.

[26] **Territories** 📌 Actions by or against territories

Under Puerto Rico law, lien held by parties holding certain revenue bonds issued by Puerto Rico Electric Power Authority (PREPA) before it entered reorganization proceedings under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) was perfected with respect to net revenues that PREPA had acquired by providing electricity, and so lien could not be avoided by Financial Oversight and Management Board for Puerto

Rico using its powers as hypothetical judgment lien creditor; bondholders' security interest was a "general intangible," bondholders had filed a timely financing statement as required to perfect their interest, and there was no contention that financing statement insufficiently described bondholders' collateral or suffered from any other flaw that would have rendered the net revenue lien unperfected. 11 U.S.C.A. § 544(a); 48 U.S.C.A. § 2161(c)(7); 19 L.P.R.A. §§ 2212(a)(42), 2233(b), 2260(a), 2267.

[27] **Judgment** 📌 Priorities Between Judgment and Other Liens or Claims

Secured Transactions 📌 Lien creditors

In Puerto Rico, a judgment lien is superior to any unperfected security interest. 19 L.P.R.A. § 2267.

[28] **Secured Transactions** 📌 Financing Statement

Under Puerto Rico law, a financing statement cannot create an interest beyond that created by the security agreement.

[29] **Bankruptcy** 📌 Elements and Exceptions

Under the Bankruptcy Code's preferences section, bankruptcy trustee may avoid a debtor's prepetition transfer of property to a creditor, if such transfer: (1) was made for an antecedent debt, (2) was made while the debtor was insolvent, (3) was made within a certain time period (usually 90 days), and (4) gives the creditor more than it would receive in a liquidation scenario that did not include the transfer. 11 U.S.C.A. § 547(b).

[30] **Bankruptcy** 📌 Ownership of interest transferred

Bankruptcy 📌 Adjustment of Debts of a Municipality

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Under the Bankruptcy Code, a Chapter 9 debtor's transfer of property for the benefit of any holder of a bond or note is not an avoidable preference. [11 U.S.C.A. §§ 547, 926\(b\)](#).

[31] Territories 🏠 [Actions by or against territories](#)

Under any plausible conception of Puerto Rico law, lien held by parties holding certain revenue bonds issued by Puerto Rico Electric Power Authority (PREPA) before it entered reorganization proceedings under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), with respect to PREPA's future net revenues, was not avoidable by Financial Oversight and Management Board for Puerto Rico using its powers as hypothetical judgment lien creditor, whether under sweeping “stream” theory urged by bondholders, whereby their perfection of lien in net revenue “stream” meant they already held perfected interest in future-acquired net revenues, under modified “stream” theory whereby bondholders' lien would attach to future net revenues when PREPA acquired them, or under no “stream” theory at all, whereby perfection would occur as soon as PREPA acquired any future net revenues. [11 U.S.C.A. § 544\(a\)](#); [48 U.S.C.A. § 2161\(c\)\(7\)](#); [U.C.C. § 9-204](#); [19 L.P.R.A. § 2233\(b\)](#).

[32] Territories 🏠 [Actions by or against territories](#)

Upon determining, on appeal from Title III court's decision in adversary proceeding in which Financial Oversight and Management Board for Puerto Rico sought disallowance of proof of claim filed by parties holding revenue bonds issued by Puerto Rico Electric Power Authority (PREPA) before it entered reorganization proceedings under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), that bondholders' lien covered PREPA's present and future net revenues, and that lien was not avoidable with respect to net revenues already

acquired, the Court of Appeals would decline to address how Title III court should account for bondholders' lien in PREPA's restructuring; there was no insight from Title III court, which, having held that no net revenue lien existed, had no occasion to discuss how to account for such lien during PREPA's restructuring, and there was no focused appellate briefing on issue from the parties. [11 U.S.C.A. § 544\(a\)](#); [48 U.S.C.A. § 2161\(c\)\(7\)](#).

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[33] Territories 🏠 [Actions by or against territories](#)

Proper amount of allowed claim held by parties holding revenue bonds issued by Puerto Rico Electric Power Authority (PREPA) before it entered reorganization proceedings under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) was face value of bonds, that is, principal plus matured interest, or roughly \$8.5 billion; bondholders had legal “right to payment” rooted in covenants outlined in governing trust agreement, to which Commonwealth's Authority Act applied, trust agreement clearly required PREPA to pay bonds in full and expressly permitted bondholders to proceed at law to challenge any breach of agreement's covenants, there was thus no need to estimate their “right to payment” under section of Bankruptcy Code governing allowance of claims or interests, and because bondholders' legal right to payment arose from debt instrument, proper amount of claim was full face amount of instrument. [11 U.S.C.A. §§ 101\(5\), 502\(b\)\(2\), 502\(c\)\(2\)](#); [48 U.S.C.A. §§ 2161-2178](#); [22 L.P.R.A. § 206\(e\)\(1\)](#).

[34] Bankruptcy 🏠 [Estimation of value](#)

Under the section of the Bankruptcy Code governing allowance of claims or interests, court may “estimate,” that is, assign a dollar amount to, a right to payment arising from a right to an equitable remedy for breach of performance. [11 U.S.C.A. § 502\(c\)\(2\)](#).

- [35] **Bankruptcy** ➡ Claims allowable; what constitutes "claim."

Creditor holds "right to payment," as required to have a "claim" under the Bankruptcy Code, when debtor is legally obligated to pay under relevant nonbankruptcy law. 11 U.S.C.A. § 101(5).

- [36] **Bankruptcy** ➡ Claims allowable; what constitutes "claim."

When a legal right to payment arises from a debt instrument, the proper amount of claim in a bankruptcy case is the full face amount of the instrument, that is, the principal plus any matured interest. 11 U.S.C.A. § 502.

- [37] **Bankruptcy** ➡ Estimation of value

Purpose of subsection of the Bankruptcy Code's estimation provision that applies to contingent or unliquidated claims is to assign a dollar amount to undetermined claims of an unsettled amount. 11 U.S.C.A. § 502(c)(1).

- [38] **Bankruptcy** ➡ Claims allowable; what constitutes "claim."

Bankruptcy ➡ Estimation of value

Subsection of the Bankruptcy Code's estimation provision that applies to contingent or unliquidated claims does not apply to "liquidated claims," that is, claims with an amount determinable by reference to an agreement or by a simple computation. 11 U.S.C.A. § 502(c)(1).

- [39] **Bankruptcy** ➡ Claims allowable; what constitutes "claim."

Bankruptcy ➡ Estimation of value

Case law around the subsection of the Bankruptcy Code's estimation provision that applies to contingent or unliquidated claims

informs the court's analysis of the subsection addressing claims arising from a right to an equitable remedy for breach of performance. 11 U.S.C.A. §§ 502(c)(1), 502(c)(2).

- [40] **Bankruptcy** ➡ Interest

Bankruptcy court must disallow any portion of a claim attributable to unmatured interest. 11 U.S.C.A. § 502(b)(2).

- [41] **Territories** ➡ Actions by or against territories

Parties holding revenue bonds issued by Puerto Rico Electric Power Authority (PREPA) before it entered reorganization proceedings under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) were nonrecourse creditors and, thus, if their collateral only satisfied part of their claim, they could not file deficiency claim for the remainder; governing trust agreement expressly stated that revenue bonds were not general obligations of the Commonwealth of Puerto Rico, bondholders' secured claim was thus payable "solely" from special revenues, such that section of the Bankruptcy Code governing limitation on recourse against Chapter 9 debtors applied and bondholders' recourse was limited to their collateral, and nothing in the trust agreement said otherwise. 11 U.S.C.A. §§ 927, 1111(b); 48 U.S.C.A. §§ 2161-2178.

- [42] **Bankruptcy** ➡ Secured Claims

Under the Bankruptcy Code, secured creditor generally has recourse against debtor on account of its secured claim, even if the creditor is otherwise nonrecourse under applicable nonbankruptcy law. 11 U.S.C.A. § 1111(b)(1) (A).

- [43] **Bankruptcy** ➡ Amount secured; partial security

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Bankruptcy 📁 Adjustment of Debts of a Municipality

Bankruptcy Code's presumption of recourse generally afforded to secured creditors does not apply to a holder of a claim payable solely from special revenues of Chapter 9 debtor. 11 U.S.C.A. §§ 927, 1111(b)(1)(A).

[44] **Bankruptcy** 📁 Amount secured; partial security

Bankruptcy 📁 Adjustment of Debts of a Municipality

Purpose of the section of the Bankruptcy Code providing that the Code's presumption of recourse generally afforded to secured creditors does not apply to a holder of a claim payable solely from special revenues of Chapter 9 debtor is to deny special revenue bondholders any recourse to the general funds of a municipality, which are often subject to statutory or constitutional limits on debt issuance. 11 U.S.C.A. §§ 927, 1111(b)(1)(A).

[45] **Bankruptcy** 📁 Secured Claims

"Nonrecourse creditor" may look only to its collateral for satisfaction of its debt and does not have any right to seek payment of any deficiency from a debtor's other assets.

[46] **Territories** 📁 Actions by or against territories

Under Puerto Rico law, Puerto Rico Electric Power Authority (PREPA) was not a trustee with respect to revenues and other moneys received, for purposes of breach-of-trust claim asserted by parties holding revenue bonds issued by PREPA before it entered reorganization proceedings under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA); governing trust agreement clearly identified a third-party financial institution and its successors, not PREPA, as trustee, particular section of agreement was properly

read as requiring PREPA to deposit moneys with "depositories," which then held the moneys in trust and applied them in accordance with agreement, and did not make PREPA itself a trustee, and Commonwealth's Authority Act required PREPA to account "as if" it were the trustee of an express trust, which language would have been unnecessary if PREPA were already a trustee with respect to all moneys received. 48 U.S.C.A. §§ 2161-2178; 22 L.P.R.A. § 208(a)(2).

[More cases on this issue](#)

[47] **Territories** 📁 Actions by or against territories

Parties holding revenue bonds issued by Puerto Rico Electric Power Authority (PREPA) before it entered reorganization proceedings under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) properly pled claim for equitable "accounting" against PREPA under Puerto Rico law; bondholders alleged that PREPA wrongfully diverted net revenues from debt service by spending them on unreasonable current expenses, thereby starving certain funds created by governing trust agreement of cash and slowing debt payments to bondholders, Commonwealth's Authority Act required PREPA to "account as if [it] were the trustee of an express trust," and parties' agreement did not limit that authority. 48 U.S.C.A. §§ 2161-2178; 22 L.P.R.A. § 208(a)(2).

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[48] **Account** 📁 Nature and grounds of right to an account

Puerto Rico statute governing requests for an accounting of unpaid obligations concerns a debtor's request for an accounting, not a creditor's request for an accounting. 19 L.P.R.A. § 2240.

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*288 APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF PUERTO RICO [Hon. Laura Taylor Swain, * U.S. District Judge]

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Before Kayatta, Howard, and Rikelman, Circuit Judges.

Opinion

KAYATTA, Circuit Judge.

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*289 In this opinion, we consider the rights of parties holding certain revenue bonds issued by the Puerto Rico Electric Power Authority (“PREPA” or “the Authority”) before it entered reorganization proceedings under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (“PROMESA”). 48 U.S.C. §§ 2161–78. We hold that these bondholders have a non-recourse claim on PREPA's *290 estate for the principal amount of the bonds, plus matured interest. We also hold that this claim is secured by PREPA's Net Revenues -- as that term is defined by the underlying bond agreement -- and by liens on certain funds created by that bond agreement. We do not decide what effect, if any, confirmation of a plan of reorganization will have on the bondholders' security interest, nor do we attempt to estimate the economic value of that security interest. Our reasoning follows.

I.

A.

Puerto Rico passed the Puerto Rico Electric Power Authority Act (“Authority Act”) in 1941. See [P.R. Laws Ann. tit. 22, § 191](#). The Authority Act created PREPA, a public electric utility. *Id.* § 193(a). More than eighty years later, PREPA remains the “sole electric utility in Puerto Rico.” [Puerto Rico Electric Power Authority \(PREPA\)](#), P.R. Fiscal Agency & Fin. Advisory Auth., <https://perma.cc/F7HA-QNVH>. It owns electrical generation, transmission, and distribution assets in the Commonwealth, and serves around 1.5 million customers. *Id.*

The Authority Act permits PREPA to raise money by issuing revenue bonds secured by its “entire gross or net revenues and present or future income.” [P.R. Laws Ann. tit. 22, § 206\(e\) \(1\)](#); see also *id.* § 196(o). In this manner, PREPA can raise money without granting a lien on its physical assets, such as power plants or transmission lines. Pursuant to the Authority Act, PREPA in 1974 executed the Trust Agreement with First National City Bank, which was then acting as trustee.¹ Under the Trust Agreement, PREPA raised money to finance its system by issuing revenue bonds (the “Revenue Bonds”). PREPA promised to repay the bondholders over time,² in accordance with the Trust Agreement. Several articles of the Trust Agreement frame the issue before us.

First, the Trust Agreement opens with a Preamble,³ the text and meaning of which we discuss in detail in Part II.A.1 of this opinion.

Second, Article I of the Trust Agreement defines key terms, including “Revenues” and “Net Revenues.” PREPA's “Revenues” are (1) “all moneys received by [PREPA] in connection with or as a result of its ownership or operation” of its electricity generation and distribution system, (2) “any proceeds of use and occupancy insurance on the System or any part thereof, and (3) “income from investments made under” either the Trust Agreement or a 1947 predecessor agreement.⁴ PREPA's “Net Revenues” are any Revenues remaining after deducting reasonable and necessary operating expenses. Article I also defines the phrase “Opinion of Counsel,” which means any opinion filed by PREPA's counsel to “authenticate bonds under [the Trust] Agreement.”

*291 Third, Article V of the Trust Agreement establishes a “waterfall” structure for distributing PREPA's Revenues (as the term is defined in Article I) into certain funds. The Revenues first flow into the General Fund.⁵ PREPA pays its reasonable operating expenses (“Current Expenses”) out of the General Fund. The remaining dollars -- the Net Revenues -- then flow into the Revenue Fund, minus a reserve to cover future operating expenses. From there, Net Revenues flow first into the Sinking Fund, and then into a series of Subordinate Funds. The Net Revenues deposited into the Sinking Fund cover debt service. The Net Revenues deposited into the Subordinate Funds cover internal PREPA operations, such as extraordinary repairs or capital improvements.

There are four Subordinate Funds: the Construction Fund,⁶ the Self-Insurance Fund, the Capital Improvement Fund, and the Reserve Maintenance Fund. If there is not enough money in the Sinking Fund to cover PREPA's debt service obligations, Article V (specifically, sections 512 through 512B) broadly requires PREPA to draw on the Subordinate Funds -- other than the Construction Fund -- to pay bondholders.

Fourth, and relatedly, Articles IV and V grant security interests in certain funds both within and outside of the waterfall structure described in Article V. Section 401 of the Trust Agreement creates a “lien and charge in favor of

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the [bondholders]" in moneys residing in the Construction Fund. Similarly, under section 507 of the Trust Agreement, the moneys in the Sinking Fund and remaining Subordinate Funds -- that is, the Subordinate Funds within the Article V waterfall -- are "subject to a lien and charge in favor of the [bondholders]." ⁷ Section 513 confirms that the Sinking Fund moneys are "pledged to and charged with" debt service payments to the bondholders.

Fifth, Article VI of the Trust Agreement specifies how PREPA should hold and invest the moneys it receives. Specifically, section 601 of the Trust Agreement states that:

All moneys received by the Authority under the provisions of this Agreement shall be deposited with a Depositary or Depositaries, shall be held in trust, shall be applied only in accordance with the provisions of this Agreement and shall not be subject to lien or attachment by any creditor of the Authority.

Sixth, Article VII of the Trust Agreement outlines specific contractual covenants between the bondholders and PREPA. In section 701, PREPA covenants that it will "promptly pay the principal of and the interest on" the Revenue Bonds. PREPA also covenants that the Revenue Bonds are "payable solely from the Revenues and said Revenues are hereby pledged to the payment thereof in the manner and to the extent hereinabove particularly specified." In sections 705 and 712, PREPA also agrees not to create -- "or suffer to be created" -- any lien or charge on "the Revenues ranking equally with or prior to the [Revenue Bonds]."

***292** Finally, Article VIII of the Trust Agreement outlines the bondholders' remedies. Section 804 permits the bondholders to file a suit "in equity or at law ... for the appointment of a receiver as authorized by the Authority Act[,] or for the specific performance of any covenant or agreement contained herein." The same provision entitles the bondholders to "recover and enforce any judgment or decree against the Authority, but solely as provided herein and in such bonds, for any portion of such amounts

remaining unpaid ... and to collect (but solely from moneys in the Sinking Fund and any other moneys available for such purpose) in any manner provided by law, the moneys adjudged or decreed to be payable."

B.

In 2017, PREPA defaulted on its fundamental obligations under the Trust Agreement, including its obligation to pay the bondholders. But for the passage of PROMESA, the Trustee and/or the bondholders could have pursued various remedies authorized by the Authority Act and the Trust Agreement. Those remedies include suits at law and/or equity to enforce contractual covenants, to obtain an accounting, and to place PREPA in receivership. [P.R. Laws Ann. tit. 22, §§ 207\(a\)–\(b\), 208\(a\)\(1\)–\(3\)](#).

[1] [2] Congress, however, changed all this by enacting PROMESA. Among other things, PROMESA created the Financial Oversight and Management Board ("FOMB" or "Board"). [48 U.S.C. § 2121\(b\)\(1\)](#). PROMESA empowered the Board to place Commonwealth entities into bankruptcy-type restructuring proceedings (often called "Title III proceedings"), which resemble municipal bankruptcy proceedings under Chapter 9 of the Bankruptcy Code. [In re Fin. Oversight & Mgmt. Bd. for P.R.](#), 919 F.3d 121, 124–25 (1st Cir. 2019); [see generally 48 U.S.C. § 2161\(a\)](#) (incorporating broad swaths of the Bankruptcy Code into PROMESA). In July 2017, the Board commenced a Title III proceeding in district court (also called the "Title III court") to restructure PREPA. [See In re Fin. Oversight & Mgmt. Bd. for P.R.](#), 899 F.3d 13, 18 (1st Cir. 2018). As a result, the bondholders' ability to pursue any remedies against PREPA under Commonwealth law was automatically stayed. [See 48 U.S.C. § 2161\(a\)](#) (incorporating [section 362 of the Bankruptcy Code](#) into PROMESA); [11 U.S.C. § 362\(a\)](#) (stating that a bankruptcy petition automatically stays actions against the debtor's estate).

After two years of on-and-off negotiations and skirmishes, the Board filed an adversary proceeding within the Title III restructuring proceeding. The purpose of the adversary proceeding was to define the rights and remedies that bondholders had against PREPA. After the parties negotiated a restructuring agreement for PREPA in 2019, the Board

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agreed not to prosecute the adversary proceeding. *See In re Fin. Oversight & Mgmt. Bd. for P.R.*, 91 F.4th 501, 506 n.3 (1st Cir. 2024). The Commonwealth's government unilaterally terminated the restructuring agreement in March 2022, so the Board moved to revive its original complaint. *Id.* at 506. The Board filed its amended complaint in October of that year, and this remains the operative complaint for purposes of this appeal. The amended complaint included three allegations that are relevant here.

First, the Board alleged that bondholders only had security interests in moneys deposited in the Sinking or Subordinate Funds. According to the Board, bondholders did not have a security interest in PREPA's current or future Revenues/Net Revenues, unless those Revenues/Net Revenues resided in the Sinking or Subordinate Funds. Second, the Board alleged *293 that bondholders only had perfected security interests in the Sinking Fund and one of the Subordinate Funds (i.e., the Self-Insurance Fund), meaning the Board could avoid the remaining unperfected interests pursuant to 11 U.S.C. § 544(a). Finally, the complaint alleged that the Revenue Bonds were non-recourse, meaning bondholders could only recover owed moneys from the lien-ed Funds, rather than any other part of PREPA's estate.

The bondholders that are parties to this case (again, “the Bondholders”) filed an answer denying the Board's allegations. The Bondholders also filed a counterclaim. Among other things, the counterclaim alleged that PREPA had misappropriated moneys “for uses other than Current Expenses instead of paying [the] [B]ondholders,” and had therefore breached its obligations to hold “all moneys received under the provisions of the Trust Agreement in trust for the benefit of the [B]ondholders.” The Bondholders asked for a declaratory judgment that PREPA was in breach of trust, and an “order requiring an accounting of PREPA's revenues” pursuant to P.R. Laws Ann. tit. 22, § 208(a)(2). According to the Bondholders, this “accounting” would require equitable disgorgement of any moneys that PREPA wrongly diverted from the Sinking and/or Subordinate Funds.

C.

On March 22, 2023, the Title III court issued a partial summary judgment order in the adversary proceeding. First,

the court agreed with the Board that the Trust Agreement only granted the Bondholders security interests in “moneys actually deposited to the Sinking Fund and the [Subordinate Funds].” The Trust Agreement did not grant a broader security interest in PREPA's current or future Revenues (or Net Revenues). Second, the court concluded that the Board could avoid any unperfected security interests under 11 U.S.C. § 544(a).⁸ Third, the Title III court rejected the Board's argument that the Revenue Bonds were non-recourse, holding instead that the Bondholders could sue PREPA to recover moneys outside the Sinking and Subordinate Funds.

With respect to the non-recourse holding, the Title III court emphasized that even though the Bondholders lacked a security interest in PREPA's Revenues or Net Revenues, section 804 of the Trust Agreement still permitted them to seek a court order forcing PREPA to divert moneys into the Sinking Fund. Recall that section 804 authorized any bondholder to sue in law or equity for the “specific performance of any covenant or agreement contained” in the Trust Agreement. In the court's view, the existence of this equitable specific performance remedy gave bondholders an unsecured deficiency claim on PREPA's Net Revenues. The precise amount of this claim would “aris[e] from liquidation of the value of the Trust Agreement's equitable remedies related to specific *294 performance.” A court may -- for purposes of claim allowance -- estimate a claim in bankruptcy “arising from a right to an equitable remedy for breach of performance.” 11 U.S.C. § 502(c)(2). The Title III court applied that provision, estimating the specific performance remedy (and therefore the unsecured claim on Net Revenues) at around \$2.4 billion.

The court's partial summary judgment order did not reach the Bondholders' trust-related arguments. But its final summary judgment order, which it issued on November 28, 2023, did. There, the Title III court concluded that the Bondholders had failed to state a claim for breach of trust. It also rejected their related demand that PREPA equitably disgorge, via an “accounting,” any misappropriated moneys pursuant to P.R. Laws Ann. tit. 22, § 208(a)(2). The court found that PREPA was not a trustee under the plain language of the Trust Agreement, and that an “accounting” under the Authority Act did not require the sweeping restitution remedy the Bondholders requested.

D.

Upon issuance of the Title III court's final summary judgment order, the Bondholders filed separate notices of appeal. The Bondholders challenged the Title III court's holdings that they lacked a security interest in PREPA's current or future Revenues or Net Revenues; that any such interest was potentially avoidable under 11 U.S.C. § 544(a); that they had failed to state a claim for breach of trust; and that they were not entitled to an "accounting" of misappropriated PREPA moneys. The Bondholders also challenged the Title III court's estimation order, arguing that the court erred by allowing an unsecured claim of \$2.4 billion, rather than almost \$9 billion (i.e., the face value of the Revenue Bonds). Alternatively, the Bondholders challenged the estimation order's methodology.

The Board and associated plaintiff-appellees -- specifically the Official Committee of Unsecured Creditors ("Committee") and the Puerto Rico Fiscal Agency and Financial Advisory Authority ("AAFAF") -- cross-appealed. In addition to rejecting the Bondholders' arguments, the Board and its allies argued that the Title III court erred in allowing any unsecured claim at all on PREPA's Net Revenues. In the Board's view, the Revenue Bonds were non-recourse, so the Bondholders could only recover from their collateral, i.e., the moneys in the Sinking and Subordinate Funds. In the alternative, the Board and its allies argued that the Title III court's \$2.4 billion estimation should be affirmed. Finally, the Board contended that if there were a lien on Net Revenues, it would be avoidable as unperfected.

We consolidated these appeals and ordered expedited briefing and oral argument.⁹

II.

We begin by asking whether the Trust Agreement grants the Bondholders a lien on any of PREPA's revenues other than *295 those that make it into the Sinking or Subordinate Funds. We hold that the Trust Agreement grants the Bondholders a lien on PREPA's Net Revenues, even if they are not placed in one of the Funds. Our reasoning follows.

A.

1.

The dispute about the scope of the Bondholders' lien begins with the Trust Agreement's Preamble. In pertinent part, the Preamble provides: "Now, Therefore, This Agreement Witnesseth, that ... in order to secure the payment of [the Revenue Bonds,] ... [PREPA] does hereby pledge to the Trustee the revenues of the System ... and other moneys to the extent provided in this Agreement as security for the payment of the [Revenue Bonds] ... , and it is mutually agreed and covenanted ... as follows"¹⁰

According to the Bondholders, the Preamble grants a lien on all of PREPA's "Revenues," which are defined as PREPA's gross revenues with several exceptions not relevant here. In sharp contrast, the Title III court found that the Preamble did not create any lien at all, let alone a lien on PREPA's gross revenues. The court gave two reasons for this conclusion.

First, the court concluded that the Preamble was a non-binding "prefatory clause" -- much like a "whereas clause" -- rather than a "self-effectuating granting clause." The Board does not defend this reading of the Preamble, calling it "beside the point." In its brief, AAFAF actually concedes that the Preamble's language is "operative." Only the Committee and a group of intervenors defend the contention that the Preamble is not operative. The former labels the clause "not an operative term at all," but rather a "lead-in" or "recital." And the latter calls the clause "prefatory."

[3] [4] We agree with the Bondholders that the Preamble is a granting clause, *296 rather than a prefatory clause. To be sure, language that only expresses the aspirations of the parties (such as a classic "whereas" clause) can be a mere table-setter, often without legal force. See *Minturn v. Monrad*, 64 F.4th 9, 15 (1st Cir. 2023). And the Trust Agreement does begin with table-setting "whereas" clauses. But the relevant Preamble language does not appear in such a clause. Instead, it debuts in a subsequent "Now Therefore ..." clause, which states that the Authority "does hereby pledge to the Trustee the revenues of the System ... and other moneys to the extent provided in this Agreement as security for the payment of the

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bonds.” (Emphasis added.) This language reflects a grant, not merely an aspiration or a description of background facts.

Puerto Rico case law supports the conclusion that the Preamble is not merely prefatory.¹¹ In a case interpreting an unrelated bond agreement, the Puerto Rico Supreme Court found that a provision beginning with “Now, Therefore” was one of the “main clauses” in the contract. [D’All Concrete Mix, Inc. v. Raúl Fortuño, Inc.](#), 14 P.R. Offic. Trans. 954, 956 (1983) (per curiam). We see no reason to read the Preamble differently, especially given that no party identifies any contrary Puerto Rico authority.

Our conclusion that the text of the Preamble is not merely prefatory brings us to the Title III court’s alternative finding that the Preamble did not create any kind of security interest because it did not use the words “lien” or “charge.” Again, the Board and its allies do not defend the court’s reasoning. The Board even concedes that the Preamble’s “pledge” is enough to create a security interest.

[5] The Board is correct. There is no “magic words” requirement for creating a security interest under Puerto Rico law. Instead, a security agreement need only “indicate an [objective] intent to create a security interest.” [In re Esteves Ortiz](#), 295 B.R. 158, 162 (B.A.P. 1st Cir. 2003) (applying Puerto Rico law). The Preamble clearly evinces such an intent. It states that “in order to secure the payment” of the Revenue Bonds, PREPA “pledge[s] ... the revenues of the System ... and other moneys to the extent provided in this Agreement as security for the payment of the bonds.” This language closely resembles language that we have previously found sufficient to create a security interest. See, e.g., [In re Navigation Tech. Corp.](#), 880 F.2d 1491, 1493 (1st Cir. 1989) (finding that an assignment of contractual rights “[t]o secure the payment of [a] debt” was enough to create a security interest).

Revealingly, the Authority Act -- which, as the Title III court found, authorizes PREPA to grant liens in its revenues -- uses the same phrasing as the Preamble. Section 206 of the Authority Act states that PREPA may “pledge[e]” its current or future revenues to “secure payment of [revenue bonds].” See [P.R. Laws Ann. tit. 22, § 206\(e\)\(1\)](#). In other words, the Authority Act expressly contemplates that a “pledge” to “secure payment” of a bond can create a security interest.

It would therefore be paradoxical to hold that the identical language in the Preamble does not create such an interest.

2.

Having established that the Preamble creates a security interest, we next determine the scope of that security interest. The Trust Agreement specifies that *297 PREPA pledges as security for the Revenue Bonds “the revenues of the System ... and other moneys to the extent provided in this Agreement ... as follows.” This text poses two questions. First, what are the “revenues of the System,” given that the Trust Agreement never expressly defines the phrase? And second, does the phrase “to the extent provided in [the Trust Agreement]” apply to both the pledge of the “revenues of the System” and the pledge of “other moneys,” or just to one of those pledges? We address each question in turn.

i.

[6] We begin with the Bondholders’ ambitious claim that the “revenues of the System” means PREPA’s Revenues (i.e., gross revenues). The Trust Agreement does not define “revenues of the System.” It does, however, define “Revenues” to mean “all moneys received by the Authority in connection with or as a result of its ownership or operation of the System [minus a variety of investments and transactions].” It also defines “Net Revenues” to mean “the excess of the Revenues ... over the Current Expenses.” By eschewing the defined terms “Revenues” and “Net Revenues” in favor of the undefined term “revenues of the System,” the Preamble’s text leaves unclear precisely what is being pledged.

[7] To resolve this ambiguity, we turn to the more fundamental rule that a court should read a contract “as a whole.” See [11 Williston on Contracts § 32:5 \(4th ed.\)](#); see also [Entact Serv., LLC v. Rimco, Inc.](#), 526 F. Supp. 2d 213, 221 (D.P.R. 2007) (citing [P.R. Laws Ann. tit. 31, § 3475](#)) (“[W]hen interpreting contracts, [a court applying Puerto Rico law] must read contract provisions in relation to one another, giving unclear provisions the meaning which arises from considering all provisions together.”). And that rule brings clarity.

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When negotiating a contract governing billions of dollars in bonds, the parties understandably agreed to accompany any bond issuance with an opinion of counsel that would confirm the creditors' rights and responsibilities. This opinion of counsel would need to describe the security that PREPA purported to provide its creditors. The parties supplied that description in section 101 of the Trust Agreement. Under section 101, an opinion of counsel must state that the Trust Agreement “creates a legally valid and effective pledge of the Net Revenues ... and of the moneys, securities and funds held or set aside under this Agreement as security for the bonds, subject to the application thereof to the purposes and on the conditions permitted by this Agreement” (Emphasis added.) We refer to this language -- which the parties drafted to direct future counsel on how to describe the collateral securing the Revenue Bonds in connection with the issuance and delivery of any such bonds -- as the “Opinion of Counsel Clause.” And given this agreed-upon description, we construe the phrase “revenues of the System” in the Preamble to mean “Net Revenues” (i.e., gross revenues minus Current Expenses) rather than “Revenues” (i.e., gross revenues).

[8] The Bondholders retort that other Trust Agreement provisions -- namely, sections 516(c), 705, and 712 -- suggest that the lien is on Revenues, not Net Revenues.¹² These provisions generally forbid PREPA from granting a lien equal or superior to the lien “secured hereby upon the *298 Revenues.”¹³ (Emphasis added.) These sections are about lien priority, not lien scope. And none of these sections says that the Bondholders' lien is secured by all the Revenues. That is, even if a bondholder were to have a lien on part of the Revenues (for example, the Net Revenues), one could still describe that lien as “upon the Revenues.” Moreover, even if the Bondholders' preferred reading were plausible, driveby references to “Revenues” must take a back seat to the drafters' focused description of the collateral in the Opinion of Counsel Clause. See Restatement (Second) of Contracts § 203, cmt. e (Am. L. Inst. 1981) (“Attention and understanding are likely to be in better focus when language is specific or exact, and in case of conflict the specific or exact term is more likely to express the meaning of the parties with respect to the situation than the general language.”).

[9] Finally, and most practically, even if the Bondholders' reading of the Trust Agreement were correct, they would

likely end up in the same place. As all parties agree, PREPA's Revenues and Net Revenues are “special revenues” under the Bankruptcy Code (a term that we define more precisely later). See infra note 15. And under the Code, any lien on special revenues is subordinate to a utility's reasonable and necessary post-petition operating expenses. See 11 U.S.C. § 928(b); 48 U.S.C. § 2161(a) (incorporating section 928 into PROMESA). Accordingly, as the Bondholders conceded at oral argument, “even a gross revenue pledge becomes a net pledge in [a Title III proceeding].” 5 Norton Bankruptcy Law & Practice § 90:13 (3d ed. 2024).

ii.

[10] The Board and its allies agree that the Bondholders do not have a lien on PREPA's gross Revenues. But they insist that this is only half the story. They argue that the Bondholders' security interest does not even attach to all Net Revenues. Instead, they claim that it attaches only to those Net Revenues that have flowed into the Sinking Fund and/or the Subordinate Funds. This argument trains on the text of the Preamble, which states in relevant part that PREPA “does hereby pledge to the Trustee the revenues of the System ... and other moneys to the extent provided in this Agreement ... as follows.” (Emphasis added.)

The Board's reasoning is thus: (1) The Preamble's revenue pledge is only “to the extent provided in [the Trust Agreement] ... as follows”; (2) section 701 of the Trust Agreement states, in turn, that PREPA's “Revenues are hereby pledged ... in the manner and to the extent hereinabove particularly specified”; (3) therefore, the Preamble and section 701 are “bookends” that limit the Bondholders' security interest to the more specific grants that appear between those two contractual provisions; (4) those more specific grants -- in sections 401, 507, and 513 -- only expressly provide for liens in the Sinking and Subordinate Funds; (5) so, the Trust Agreement narrows the Preamble's revenue pledge to those Net Revenues that are actually deposited into the Sinking and Subordinate Funds.

The first step in this argument poses a classic antecedent puzzle. Recall that in the Preamble, the modifying phrase “to the extent provided in [the Trust Agreement]” immediately follows the pledge of “other moneys.” But the Board's

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argument assumes that this modifying phrase applies to both of its antecedent phrases: “revenues *299 of the System” and “other moneys.” Put differently, in the Board’s view, the Preamble pledges (1) the “revenues of the System ... to the extent provided in [the Trust Agreement],” and (2) “other moneys to the extent provided in [the Trust Agreement].” Unsurprisingly, the Bondholders counter that the phrase “to the extent provided in [the Trust Agreement]” modifies only its immediate antecedent: “other moneys.”

[11] The parties’ respective readings rely on arguably opposing interpretative canons. On the one hand, “[w]hen several words are followed by a clause which is applicable as much to the first and other words as to the last, the natural construction of the language demands that the clause be read as applicable to all.” [Paroline v. United States](#), 572 U.S. 434, 447, 134 S.Ct. 1710, 188 L.Ed.2d 714 (2014) (quoting [Porto Rico Ry., Light & Power Co. v. Mor](#), 253 U.S. 345, 348, 40 S.Ct. 516, 64 L.Ed. 944 (1920)). In a prior PROMESA case, we cited [Paroline](#) to interpret a similar bond agreement between creditors and Puerto Rico’s government employee pension system. See [In re Fin. Oversight & Mgmt. Bd. for P.R.](#), 948 F.3d 457, 467 (1st Cir. 2020) (“[Andalusian](#)”). There, the bond agreement defined “Employers’ Contributions” as “the contributions ... made by the Employers and any assets in lieu thereof or derived thereunder which are payable to the System pursuant to [certain statutory sections].” [Id.](#) at 464. We rejected the argument that the modifying phrase beginning with “which are payable to the System” only applied to its immediate antecedent: “any assets in lieu thereof or derived thereunder.” [Id.](#) at 467. Instead, we found that the modifying phrase also naturally referred to “the contributions ... made by the Employers.” [Id.](#) The Board urges us to reach a similar conclusion here: that the “to the extent” phrase applies to both of its antecedents.

[12] On the other hand, there is the canon of the last antecedent. This canon of statutory interpretation broadly prescribes that “a limiting clause or phrase ... should ordinarily be read as modifying only the noun or phrase that it immediately follows.” [Barnhart v. Thomas](#), 540 U.S. 20, 26, 124 S.Ct. 376, 157 L.Ed.2d 333 (2003). If we apply this canon, then the “to the extent” phrase underlined above only modifies its immediate antecedent: “other moneys.” Thus, the Preamble would pledge (1) “the revenues of the System,” and (2) “other moneys to the extent provided in [the Trust Agreement].”

Faced with the opposing indications of two interpretative guides, we opt for the interpretation that the drafters sanctioned in the Opinion of Counsel Clause. Notably, that clause both “follows” the Preamble and comes before section 701’s command to construe the Trust Agreement’s revenue pledge “in the manner and to the extent hereinabove particularly specified.” And in describing the security granted by the Trust Agreement to protect bondholders, the clause states in pertinent part that the Trust Agreement establishes a “legally valid and effective pledge of the Net Revenues ... and of the moneys, securities and funds held or set aside under this Agreement as security for the bonds.” (Emphases added.) This language -- with its two “and[s]” -- draws a clear grammatical distinction between the pledge of the “Net Revenues” and the pledge of the “moneys, securities and funds held or set aside under this Agreement.” That distinction runs directly counter to the Board’s contention that the Trust Agreement only pledges Net Revenues to the extent they reside in the Sinking or Subordinate Funds.

In agreeing on how to describe the Revenue Bonds’ collateral to potential investors *300 in the Opinion of Counsel Clause, the parties presumably used words that accurately conveyed their mutual intent. We are loath to read ambiguous language in the Trust Agreement in a manner suggesting that the Agreement calls for investors to be misled, as would be the case if we were to hold that the Bondholders’ collateral was limited to moneys in the Sinking and Subordinate Funds. See [Asociacion de Condominos v. Centro I, Inc.](#), 6 P.R. Offic. Trans. 257, 268 (1977) (explaining that contract interpretation should consider practical consequences of a proffered reading). We also find it very unlikely that an objectively reasonable party to the transaction giving rise to the Revenue Bonds would have expected the source of repayment not to be subject to a lien while in the debtor’s hands.

To defend its preferred reading, the Board embraces the Title III court’s view that the Trust Agreement cannot create overlapping liens in the Net Revenues and the moneys in the Sinking and Subordinate Funds. The basic argument here is that if the Bondholders have a lien on all Net Revenues, then the Fund-specific liens outlined in sections 401, 507, and 513 would be superfluous, because the Sinking and Subordinate Funds also contain Net Revenues. But at least one Subordinate Fund -- the Construction Fund -- also

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includes bond proceeds, which the parties agree are not Net Revenues.¹⁴ So, at least one Fund-specific pledge covers moneys not captured by the pledge of the Net Revenues.

[13] To be sure, that still leaves us construing the text as granting an arguably superfluous lien in (at least) the Sinking Fund. But such superfluity is hardly unheard of in revenue bond agreements. See [In re Las Vegas Monorail Co.](#), 429 B.R. 317, 325, 333 (Bankr. D. Nev. 2010) (interpreting a contract that granted a lien against net revenues, even though the creditor also held liens in the funds that received those net revenues); cf. [Unisys P.R., Inc. v. Ramallo Bros. Printing](#), No. CE-89-754, 1991 WL 735351, at *11 (P.R. Off. Trans.) (noting that when interpreting a contract, a court may consider the parties' intent in light of prevailing industry practices). Indeed, in this case, such a belt-and-suspenders approach likely offered valuable assurance to the bondholders. For example, section 507 of the Trust Agreement states that the Sinking Fund is held by the Trustee, not by PREPA. By expressly noting that the Sinking Fund is “subject to a lien and charge” in favor of the bondholders, the Trust Agreement eliminates any risk that the transfer of moneys from the PREPA-held Revenue Fund to the Trustee-held Sinking Fund would impair the lien initially placed on those moneys as Net Revenues. Given this context, the mere fact that our interpretation of the Trust Agreement creates superfluity is not enough to invalidate it. See [Restatement \(Second\) of Contracts](#) § 203, cmt. b (1981) (“Even agreements tailored to particular transactions sometimes include overlapping or redundant or meaningless provisions.”).

The Board also points to section 601 of the Trust Agreement, which states in pertinent part: “All moneys received by [PREPA] under the provisions of this Agreement ... shall not be subject to lien or attachment by any creditor of [PREPA].” According to the Board, this provision means that no lien can attach to Net Revenues in their liminal, pre-Sinking Fund (or pre-Subordinate Fund) state. This argument proves too much. The Sinking *301 and Subordinate Funds contain only “moneys received” by PREPA. If “moneys received” are not subject to a lien, then section 601 would cast doubt on every lien created by the Trust Agreement. And it would undo the work done by both the Preamble and the Opinion of Counsel Clause.

The more sensible reading of section 601 is that no non-bondholder creditor may -- absent the bondholders' consent -- secure a lien on moneys received by PREPA. This reading aligns with the Authority Act, which states that “[n]o lien whatsoever may be placed on the assets of [PREPA] insofar as the Trust Agreement with the bondholders or other agreements with the creditors of [PREPA] do not allow.” [P.R. Laws Ann. tit. 22, § 196\(o\)](#). Thus, the Authority Act distinguishes between agreements with “bondholders” and agreements with PREPA's other “creditors.” *Id.* And if we apply this distinction to section 601, then that provision's prohibition on “lien or attachment by any creditor of [PREPA]” clearly refers to creditors that are not bondholders. (Emphasis added.) By contrast, section 601 does not bar bondholders from obtaining a lien on “moneys received” by PREPA. On the contrary, it guarantees that any such lien is presumptively superior to a lien held by a non-bondholder creditor.

In sum, we find that as security for the Revenue Bonds, PREPA pledged the Net Revenues and not just those moneys that made it into the Sinking and Subordinate Funds.

B.

[14] We have established that the Bondholders have a lien on PREPA's Net Revenues. But that is not the end of the matter. The parties disagree on a more fundamental question: Does the lien on Net Revenues also apply to future Net Revenues, i.e., Net Revenues that PREPA has not yet acquired? We conclude that the answer is yes. Our reasoning follows.

1.

[15] [16] Commonwealth law determines whether -- and to what extent -- a trustee or bondholder may have a security interest in the assets of a bankrupt borrower. See [Butner v. United States](#), 440 U.S. 48, 54 & n.9, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979). Here, the Authority Act expressly permits PREPA to pledge the “entire gross or net revenues and present or future income of [PREPA], including the pledging of all or any part thereof to secure payment” of the Revenue Bonds. [P.R. Laws Ann. tit. 22, § 206\(e\)\(1\)](#). Puerto Rico has also adopted the Uniform Commercial Code (“UCC”), which

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sanctions security interests in “after-acquired collateral,” i.e., liens extending to property that the debtor does not possess at the time of the underlying security agreement (also known as “floating liens”). *P.R. Laws Ann. tit. 19, § 2234(a)*; see also *U.C.C. § 9-204*, cmt. 2 (Unif. L. Comm’n 2024) (“[A] security interest arising by virtue of an after-acquired property clause is no less valid than a security interest in collateral in which the debtor has rights at the time value is given.”). In sum, several provisions in Commonwealth law establish that the Bondholders may hold a security interest in yet-to-be-acquired Net Revenues.

[17] [18] [19] [20] [21] Congress has also recognized that a revenue bond can be secured by future income. Under *section 552(a) of the Bankruptcy Code*, a lien on after-acquired property does not attach to property acquired after the debtor files for bankruptcy. See *11 U.S.C. § 552(a)*. But *section 928 of the Bankruptcy Code* makes clear that a lien on “special revenues” -- like the one at issue here -- continues to attach to revenues *302 acquired post-petition, notwithstanding the general bar in *section 552(a)*.¹⁵ See *11 U.S.C. § 928(a)*. As the legislative history shows, Congress passed *section 928* to alleviate the concern that municipalities would use *section 552(a)* to avoid “long-term pledges of [project-specific] revenues.” See S. Rep. No. 100–506, at 25 (1988) (appended letter providing views of Department of Justice). Thus, the Bankruptcy Code not only recognizes that a debtor may grant a lien on future revenues -- it also expressly states that such liens continue to attach to revenues acquired after the filing of a bankruptcy petition.

Several courts have also considered the scope of a municipal revenue lien like the one before us. And all of them have concluded (or at least implied) that a revenue lien can extend to revenues to be acquired at a later date. See, e.g., *In re Jefferson County*, 474 B.R. 228, 266 (Bankr. N.D. Ala. 2012) (holding that under Alabama law, a revenue lien is a lien on a “source of revenues,” rather than a “possessory lien” on revenues already acquired); *In re City of Chester*, 655 B.R. 555, 567 (Bankr. E.D. Pa. 2023) (recognizing a lien on revenues “payable or to be received” by the city (emphasis added)); *In re Fin. Oversight & Mgmt. Bd. for P.R.*, 931 F.3d 111, 116 (1st Cir. 2019) (noting in passing dictum that applying *section 552(a)* to special revenue bonds risks the “termination of creditors’ security interests in future special

revenues”). We have not discovered -- nor has the Board identified -- any contrary authority.

Thus, Puerto Rico law, the Bankruptcy Code, and prior case law all indicate that the Net Revenues that PREPA acquires in the future will be subject to the pledge of Net Revenues made by PREPA in the Trust Agreement.

2.

The Board nevertheless lodges several objections to the conclusion that the Bondholders’ lien extends to PREPA’s future Net Revenues.

i.

The Board argues that under our opinion in *Andalusian*, a revenue lien cannot extend to future-acquired revenues. But *Andalusian* is inapposite. That case involved bonds issued by Puerto Rico’s Employees Retirement System (“ERS”), which were secured by employer contributions to the ERS’s multi-employer pension plan. See 948 F.3d at 462–64.

[22] For two main reasons, this court held that the ERS bondholders’ lien on employer contributions did not attach to post-petition contributions. First, the court reasoned that the future employer contributions were not “proceeds” within the meaning of *Bankruptcy Code section 552(b)(1)* because their receipt depended on intervening appropriation by the Puerto Rico legislature.¹⁶ *Id.* at 467–70. So, ERS had a “mere expectancy” of receiving future employer contributions, not a conveyable right of receipt that could support a *303 *section 552(b)(1)* claim on the post-petition proceeds of that pre-petition collateral. *Id.* at 468 & n.8. Second, the court found that employer contributions to ERS were not special revenues within the meaning of *section 928(a)*. *Id.* at 463, 473. Therefore, the ERS bondholders could not rely on that section to avoid *section 552(a)*’s general rule that pre-petition floating liens are ineffective as to collateral acquired post-petition.

Here, though, the parties agree that PREPA’s Net Revenues -- unlike the contributions at issue in *Andalusian* -- are special revenues within the meaning of *section 928(a)*. That status by itself distinguishes this case from *Andalusian* unless we

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were to treat its discussion of special revenues as superfluous, which we will not.

ii.

[23] The Board next argues that recognizing any interest in future PREPA Net Revenues is contrary to the Commonwealth's adoption of Article 9 of the UCC. The Board contends that a security interest cannot attach to property under the UCC until (1) the property exists; and (2) the debtor has a transferable right in that property. As a general proposition, this is true. See P.R. Laws Ann. tit. 19, § 2233(a) (explaining that a security interest attaches when it becomes enforceable); id. § 2233(b) (providing that a security interest is enforceable when, among other things, “the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party”).

[24] [25] However, the Board's argument proves only that a creditor cannot enforce a floating lien with respect to specific units of yet-to-be-acquired collateral. See U.C.C. § 9-204, cmt. 2 (validating a “floating lien” in a debtor's “existing and (upon acquisition) future assets” (emphasis added)). For example, the floating lien does not permit Bondholders to demand now Net Revenues that the debtor will receive in five years. But this does not mean that PREPA cannot convey an initial overarching interest in any Net Revenues that come through the door in five years. In other words, the Board's objection goes to when a revenue lien attaches to (and is perfected with respect to) future Net Revenues. It does not undermine our initial conclusion that, under Commonwealth law, a debtor may convey a lien on future Net Revenues. See P.R. Laws Ann. tit. 19, § 2234(a); P.R. Laws Ann. tit. 22, § 206(e)(1).

3.

We also address an argument raised by the Title III court, but not by the Board. In its opinion below, the court agreed with us that PREPA could grant a lien that would attach to its future-acquired revenues, but it found “no evidence” that PREPA had actually done so. However, both the Board and the Bondholders construe the pledged collateral as encompassing moneys received after the signing of the Trust Agreement. To

construe it otherwise would suggest that the bondholders paid billions in return for a pledge of Net Revenues that applied only to the small amount of Net Revenues already received and retained the day the Trust Agreement was executed. See Asociacion de Condominos, 6 P.R. Offic. Trans. at 268 (considering the practical consequences of a proposed contractual interpretation).

III.

[26] As an alternative basis for affirming, the Board argues that even if the Bondholders have a lien on PREPA's current and future Net Revenues, that lien is avoidable under 11 U.S.C. § 544(a). Section 544(a) grants the bankruptcy trustee (or, *304 in a PROMESA case, the Board) the powers of a hypothetical creditor who “extends credit ... at the [beginning] of the case,” and thereby obtains “a [judgment] lien on all property on which a creditor on a simple contract could have obtained such a [judgment] lien.” See 11 U.S.C. § 544(a); 48 U.S.C. § 2161(c)(7).

[27] In Puerto Rico, a judgment lien is superior to any unperfected security interest. See P.R. Laws Ann. tit. 19, § 2267. So, if the Net Revenue lien is unperfected, then the Board may avoid it. The Title III court did not address whether the Net Revenue lien was perfected because it concluded that no such lien existed. Having established that the Net Revenue lien exists, and with the benefit of full argument and briefing, we conclude that it is perfected, or will be perfected, at the very latest, immediately upon PREPA's acquisition of those Net Revenues. This means no hypothetical judgment creditor can outrank the Bondholders with respect to those Net Revenues.

A.

In arguing to the contrary, the Board and its allies contend that there is a mismatch between the nature of the collateral and the form of perfection attempted by the Bondholders. The Board argues that because the Net Revenues pledged as collateral consist “of the excess of the Revenues ... over the Current Expenses,” and “revenues” consist of “all moneys received by” PREPA, Trust Agreement § 101, the Net Revenues should be classified as either “money” or “deposit accounts.” And

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given that a security interest in collateral classified as such is not perfected by the means employed by the Bondholders (i.e., filing a financing statement), FOMB argues that the Bondholders lack a perfected interest in the Net Revenues. The Bondholders do not dispute that a security interest in collateral classified as “money” or “deposit accounts” is not perfected by the filing of a financing statement. Instead, they argue that PREPA’s Net Revenues as pledged in the Trust Agreement are more properly classified as either “accounts” or “general intangibles” -- security interests that all parties agree are perfected by the filing of a financing statement.

We consider first the Board’s superficially attractive claim that PREPA’s “moneys” as collateral should be classified as “money.” As the Board acknowledges, though, the term “money” as used to classify collateral for purposes of perfection “[m]eans a medium of exchange authorized or adopted by a ... government,” [P.R. Laws Ann. tit. 19, § 451\(24\)](#); i.e., currency. And no party points to any indication in the record that any substantial portion of the collateral subject to dispute was received in the form of currency.

So, that leaves the Board with its other candidate for classifying Net Revenues as a form of collateral -- a “deposit account.” A deposit account is a “demand, time, savings, passbook, or similar account maintained with a bank.” [Id.](#) § 2212(a)(29). The Board argues that when the Net Revenues flow into any one of the many funds recognized by the Trust Agreement, the “security interest in those revenues becomes a security interest in a ‘deposit account.’” [See In re O.P.M. Leasing Servs., Inc.](#), 46 B.R. 661, 670 n.5 (Bankr. S.D.N.Y. 1985) (explaining that, where “the parties clearly intended to create a security interest in the money” in their agreement, that security interest continued to attach to the deposit account into which the money was deposited). Here, though, Article I of the Trust Agreement effected a conditional pledge of both “the Net Revenues ... and of the ... funds held or set aside ... as security for the bonds.” (Emphases added.) Further bolstering the conclusion that ***305** the parties intended to treat the Net Revenues and the funds as distinct entities is the fact that some but not all of the funds are held or set aside as collateral themselves. Trust Agreement § 507. This favors the view that the Bondholders have a security interest in the Net Revenues that PREPA receives from its ownership and operation of its energy system, whether or not they are held at any moment in any particular bank account. We therefore remain unconvinced that the special revenues

defined as PREPA’s current and future Net Revenues are best themselves categorized as only a deposit account under this particular agreement.

Treating the collateral as the moneys that are not currency rather than just the deposit accounts into which those moneys move and out of which they exit at any moment also aligns with the manner in which the Trust Agreement allows the debtor to directly control the several funds that separate operating and other costs from the revenues net of those costs.

That leaves “accounts” and “general intangibles” as the remaining options. Which one we choose has no effect on the outcome of this appeal because the parties agree that perfection in either case requires the filing of a financing statement -- which all agree the Bondholders have done.

In our initial, now withdrawn opinion, we settled on “account” as the better option. The Board, though, makes a reasonable argument that an “account” might describe PREPA’s receivables, but it provides a poor fit for PREPA’s present or future receipts. Puerto Rico defines an “account” as, inter alia, “a right to payment of a monetary obligation ... for energy provided or to be provided.” [P.R. Laws Ann. tit. 19, § 2212\(a\)\(2\)\(v\)](#). While the Bondholders have a right to repayment by PREPA, and PREPA acquires rights to repayment by its customers, nothing in the Trust Agreement seems to convey any pledge of either such right. Rather, PREPA pledged its receipts, net of expenses. And the Bondholders point to no authority treating a pledge of receipts as necessarily encompassing the receivables that give rise to these receipts. So, without necessarily deciding the issue, we assume the Board is correct and turn our focus to the category of “general intangibles,” which is after all something of a catch-all for interests that do not fit other categories.

The Commonwealth defines “general intangibles” as a form of collateral that is “personal property,” but is not “accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, life insurance policies, money, and oil, gas, or other minerals before extraction.” [Id.](#) § 2212(a)(42) (emphases added). No party argues that Net Revenues are not personal property or that we should consider as options any of the listed types of personal property other than accounts, deposit accounts, or money. So, given our findings and assumption concerning those options, we are left

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to conclude that the Net Revenues under the Trust Agreement are best categorized as a form of general intangibles.

The Board cites two cases in opposition to this conclusion. [In re O.P.M. Leasing Services](#) held that an escrow account was not a general intangible because it was “for all intents and purposes, money”; but the court failed to consider whether the money in question was actually hard currency, even as it relied only on a case in which the money was clearly hard currency. See 46 B.R. at 670 n.5 (citing [In re Midas Coin Co., Inc.](#), 264 F. Supp. 193 (E.D. Mo. 1967), *aff’d sub nom* *306 [Zuke v. St. Johns Cmty. Bank](#), 387 F.2d 118 (8th Cir. 1968)). The Board also cites [In re Barr](#), which also held that certain property (utility deposits) was not a general intangible because it was money. 180 B.R. 156, 160 (Bankr. N.D. Tex. 1995). Yet, again, that court did not consider at all the definition of money applicable here -- instead, it focused its discussion on a “utility deposit ... used to secure performance of contractual rights.” [Id.](#) More closely on point, the court also held that profits of a cooperative credited to a patron, but not yet paid to the patron, constituted a general intangible. See [id.](#) at 159; see also [In re Beck](#), 96 B.R. 161, 163 (Bankr. C.D. Ill. 1988) (accepting party's uncontested assertion that retained earnings account was a general intangible). Meanwhile, two of the Bondholders cite a case even more closely apposite: [In re Ocean Place Development, LLC](#), 447 B.R. 726 (Bankr. D.N.J. 2011). There, the court found that the pledged revenues of money received from the debtor's operations should be characterized as “ ‘accounts’ or ‘payment intangibles,’ as defined under Article 9.” 447 B.R. at 737.¹⁷ In short, while scant, the case law favors the view that PREPA's Net Revenues as such should be classified as a general intangible for purposes of determining whether a lien in those revenues has been perfected.

This is not to say that all special revenues should be classified as we classify them. Different agreements may warrant different treatments. We simply hold that under this Trust Agreement, the security interest in PREPA's Net Revenues received now or in the future that are not held in the form of currency are best classified as general intangibles. And that conclusion leaves us as before -- the Bondholders have perfected their lien with respect to PREPA's Net Revenues.

[28] In Puerto Rico, an interest in a general intangible is perfected by filing a financing statement. [P.R. Laws Ann.](#)

[tit. 19, § 2260\(a\)](#). A financing statement is valid for at least five years. [Id.](#) § 2335(a); see also [id.](#) § 2335(f) (providing that a financing statement lasts indefinitely where “debtor is a transmitting utility and a filed financing statement so indicates”). Here, the Bondholders filed an updated financing statement in August 2013, which described the underlying collateral as the “Revenues of the System (as each such term is defined in the Agreement) and other moneys to the extent provided in the Agreement.”¹⁸ The Board filed its restructuring petition for PREPA in July 2017, so the August 2013 financing statement was timely. Moreover, the Board does not argue that the August 2013 financing statement insufficiently described the Bondholders' collateral or suffered from any other flaw that would render the Net Revenue lien unperfected.

Accordingly, the Bondholders have perfected their lien with respect to Net Revenues that PREPA acquires. See [P.R. Laws Ann. tit. 19, § 2233\(b\)](#) (providing that a security interest attaches once a “debtor has rights in the collateral or the power to transfer rights in the collateral to a secured *307 party”); [id.](#) § 2258 (instructing that perfection requires attachment).

B.

The Board also argues that because future Net Revenues do not yet exist, it can avoid any lien in those future Net Revenues. To see why this is not so requires some background on the applicable law.

[29] Under 11 U.S.C. § 547(b), a bankruptcy trustee may avoid a debtor's pre-petition transfer of property to a creditor, if such transfer: (1) was made for an antecedent debt; (2) was made while the debtor was insolvent; (3) was made within a certain time period (usually ninety days); and (4) gives the creditor more than it would receive in a liquidation scenario that did not include the transfer. See also 5 [Collier on Bankruptcy](#) ¶ 547.01 (16th ed. 2023) (providing an overview of [section 547](#)). Before 1978, a body of case law emerged to reconcile [section 547](#)'s language on pre-petition transfers with the UCC's recognition of liens on after-acquired property. See, e.g., 4 [White & Summers' Uniform Commercial Code](#) § 32:24 nn. 2–5 (6th ed. 2023) (collecting authorities). To understand the problem, consider a simplified example of a creditor with a lien on a merchant's revolving inventory (i.e., a

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lien on after-acquired property). If we conceive of the creditor as holding a distinct lien on each unit of inventory, which arises only as the inventory is acquired, then -- all else being equal -- any liens on inventory acquired in the ninety-day pre-petition period would arguably be avoidable as preferences under [section 547](#). The upshot is that the creditor would have no bulletproof lien on inventory acquired even months before the bankruptcy petition date.

To avoid this outcome, several courts proposed the “entity” or “stream” conception of liens on after-acquired property. See, e.g., [Grain Merchs. of Ind., Inc. v. Union Bank & Sav. Co.](#), 408 F.2d 209, 215–17 (7th Cir. 1969); [DuBay v. Williams](#), 417 F.2d 1277, 1287 n.8 (9th Cir. 1969) (describing the idea in dicta without adopting it); [Manchester Nat'l Bank v. Roche](#), 186 F.2d 827, 831 (1st Cir. 1951) (same). On this view, the creditor's security interest was not in each individual piece of inventory. Instead, the interest was in the “entity of [inventory] as a whole, and not in the individual components, so that the [relevant] transfer of property occurred [] when the interest in the [inventory] as an entity was created and the financing statements were duly filed,” rather than when the debtor acquired rights in a particular piece of inventory. [Grain Merchs.](#), 408 F.2d at 216. One commentator put it in more philosophical terms, suggesting that “[t]he secured creditor's interest is in the stream of accounts flowing through the debtor's business, not in any specific accounts. As with the Heraclitean river, although the accounts in the stream constantly change, we can say it is the same stream.” William E. Hogan, [Games Lawyers Play with the Bankruptcy Preference Challenge to Accounts and Inventory Financing](#), 53 Cornell L. Rev. 553, 560 (1968).

Congress amended the Bankruptcy Code in 1978 to overrule [Grain Merchants](#), noting that for preference purposes, the relevant transfer only occurred when “the debtor has acquired rights in the property transferred.” 11 U.S.C. § 547(e)(3); see also [S. Rep. No. 95-989](#), at 89 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5875 (expressing intent to overrule [Grain Merchants](#)). In its briefing, the Board implies that by adopting what would become [section 547\(e\)\(3\)](#), Congress expressly “disapprov[ed] of the ‘stream’ [conception]” of after-acquired property that the pre-1978 cases espoused, and which the Bondholders seem to endorse.

***308 [30]** Just a decade later, though, Congress executed a u-turn by adding [section 926\(b\)](#) to the [Bankruptcy Code](#).

Under that provision, a transfer of property “for the benefit of any holder of a bond or note” is not avoidable under [section 547](#). 11 U.S.C. § 926(b). So, at least with respect to revenue bond payments, Congress appeared to resurrect the pre-1978 “stream” or “entity” theory of after-acquired property. And the legislative history suggests as much. To quote the accompanying Senate committee report: “[I]n the municipal finance context, if the lien on future revenues is voided as a preference, the result is at odds with public policy and state enabling legislation which almost invariably provides that pledges of such revenues are effective when made and good against other creditors.” S. Rep. No. 100-506, at 7 (1988) (emphases added).

[31] The “stream” or “entity” theory discussed in [Grain Merchants](#) -- and reiterated in the legislative history of [section 926\(b\)](#) -- resembles the theory that the Bondholders advance now. In essence, the Bondholders argue that their lien covers the “stream” of Net Revenues as a whole, not the individual batches of Net Revenues as they come in the door. Thus, the Bondholders argue that by virtue of their perfected lien in the “stream” of Net Revenues, they currently hold perfected interests in both already-acquired and future-acquired Net Revenues.

Puerto Rico has not expressly adopted a “stream” theory of after-acquired collateral. Nor is there any Commonwealth case that applies the reasoning from [Grain Merchants](#) (or Congress's adoption of [section 926\(b\)](#)) to revenue bonds. We therefore hesitate to endorse the Bondholders' sweeping assertion that -- under Commonwealth law -- their perfected lien on the Net Revenue “stream” means they hold an already-perfected interest in future-acquired Net Revenues.

Moreover, even if we were to assume that Commonwealth law recognizes the “stream” theory in some form, it does not follow that the Bondholders currently have a perfected lien on all not-yet-acquired Net Revenues. Indeed, some commentators read [Grain Merchants](#) as holding that lien attachment (and therefore the potential for perfection) still only arises when the debtor acquires the collateral. On this view, when a creditor holds a lien in a collateral “stream,” the creditor does not automatically hold a perfected interest in each piece of collateral within that “stream.” Instead, the creditor's interest in a piece of collateral attaches upon acquisition and is treated as if perfected at the time of the initial financing statement. See, e.g., Rafael I. Pardo,

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[On Proof of Preferential Effect](#), 55 Ala. L. Rev. 281, 305 (2004) (“[T]he [Grain Merchants](#) lien creditor test related the timing of the transfer of a security interest acquired under a floating lien back to the filing of a financing statement by the secured party.”); Richard F. Duncan, [Preferential Transfers, the Floating Lien, and Section 547\(c\)\(5\) of the Bankruptcy Reform Act of 1978](#), 36 Ark. L. Rev. 1, 7 n.29 (1982) (noting that a security interest in after-acquired collateral would be perfected “under the earlier filing”). This slightly modified approach to the “stream” theory finds some footing in Commonwealth law. As noted above, under Commonwealth law, a lien attaches to property upon acquisition. [P.R. Laws Ann. tit. 19, § 2233\(b\)](#); [see also U.C.C. § 9-204](#), cmt. 2. It therefore seems to follow that the Bondholders cannot currently hold a perfected lien in property that PREPA has not yet acquired.

Ultimately, we need not identify the precise contours of the Commonwealth law governing attachment and perfection. ***309** Under any plausible conception of Commonwealth law, the Bondholders' lien on future-acquired Net Revenues is not avoidable. If the Commonwealth adopts the Bondholders' sweeping view -- i.e., that their perfection of the lien in the Net Revenue “stream” means they already hold a perfected interest in future-acquired Net Revenues -- then the lien is clearly unavoidable. If the Commonwealth adopts the modified conception of “stream” theory discussed above, then the Bondholders' lien will attach to future Net Revenues when PREPA acquires them, at which point the lien will be treated as if it was perfected at the time of the initial financing statement. And if the Commonwealth adopts no “stream” theory at all, then perfection would also occur as soon as PREPA acquires any future Net Revenues. [See P.R. Laws Ann. tit. 19, § 2258](#) (“A security interest is perfected when it attaches if the applicable requirements are satisfied before the security interest attaches.”). In that case, there would be no intervening period during which a judgment creditor could obtain a superior lien. [Cf. Arthur J. Harrington, Insecurity for Secured Creditors: The Floating Lien and Section 547 of the Bankruptcy Act](#), 63 Marq. L. Rev. 447, 467 n.75 (1980) (“Since attachment is immediate, there is simply no intervening time between the debtor's acquisition of the collateral and perfection of the secured party's rights ... during which the [judgment] creditor's right can attach to the debtor's inventory and accounts receivable.”). Thus, [section 544\(a\)](#) would not apply.

Accordingly, we hold that the Bondholders' lien is not avoidable under [section 544\(a\)](#).¹⁹

IV.

[32] We have held that the lien granted by the Trust Agreement covers PREPA's present and future Net Revenues and that the Bondholders' lien is not avoidable. This leaves unanswered the following question: How should the Title III court account for that lien in PREPA's restructuring? Some of the Bondholders ask us to the answer that question now. We decline to do so.

Without focused briefing from the parties or insight from the Title III court, it is difficult to determine precisely what must be decided. The Title III court never discussed how to account for a Net Revenue lien during PREPA's restructuring. It had no occasion to do so, because it held that no lien in the Net Revenues existed. Instead, the court answered the materially different question of how to account for a lien that covered only moneys in the Sinking and Subordinate Funds.

In their briefing, some Bondholders point to the Title III court's suggestion that a plan of adjustment will “cut[] off accretions of the [Bondholders'] security interest.” They argue that this language amounts (incorrectly, they say) to a holding that a plan of adjustment can unilaterally “cut off” the Bondholders' security interest, no matter what form that interest takes. But the court's language only applied to a lien on the Sinking and Subordinate Funds. Basically, the court held that a plan of adjustment would discharge PREPA's contractual obligation to replenish the Sinking and Subordinate Funds. ***310** Therefore, any “accretions” to those Funds would stop on the confirmation date, meaning the Bondholders' security interests in those Funds would not grow in value after the confirmation date. That holding says nothing about the extent to which a lien on Net Revenues received post-confirmation is dischargeable in a plan of adjustment.

We therefore decline to tell the Title III court -- in the first instance and without adequate briefing -- how it should deal with the Bondholders' Net Revenue lien during plan confirmation. In working through the difficult, novel, and important questions posed by the Title III proceedings in this case and others, we have found the considered opinions and

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insights of the Title III court to be extremely helpful. This has been true even in the handful of cases (like this one) where we have, with the benefit of time and further briefing, arrived at a different outcome.

V.

Next, the parties ask us to consider two disputes regarding related questions that the Title III court did address: (1) What is the size of the claim that the Net Revenue lien secures?; and (2) If the Bondholders' collateral only satisfies part of that claim, may the Bondholders file a deficiency claim for the remainder?

A.

[33] We start with the first question: What is the amount of the Bondholders' claim on PREPA's estate? We conclude that the proper amount of the Bondholders' claim is the face value (i.e., principal plus matured interest) of the Revenue Bonds.

1.

We begin by summarizing the Title III court's holding on this question. In the proceedings below, the court concluded that the Bondholders only had a secured claim on moneys deposited into the Sinking and Subordinate Funds. As our preceding discussion makes clear, we do not share this view. But the Title III court also found that the Bondholders had an unsecured claim on PREPA's Net Revenues, even if they were not yet deposited in the Sinking and Subordinate Funds.

To understand the Title III court's finding, we must look to [section 101\(5\) of the Bankruptcy Code](#). Under that section, a creditor can have two types of claim on a bankrupt debtor's estate. First, a creditor's claim can stem from a "right to payment." 11 U.S.C. § 101(5)(A). Second, a creditor's claim can stem from a "right to an equitable remedy for breach of performance[.]" if such breach gives rise to a right to payment." *Id.* § 101(5)(B).

The Title III court found that the Bondholders' unsecured claim on Net Revenues derived from a "right to an equitable

remedy for breach of performance." *Id.* Recall the remedies outlined in the Trust Agreement. If PREPA breached its contractual covenant to transfer Net Revenues into the Sinking and Subordinate Funds, then the Bondholders could force PREPA to change course by placing PREPA into receivership, or by seeking specific performance. Those are equitable remedies. And those remedies would, by definition, reach Net Revenues not yet deposited into the Sinking and Subordinate Funds. Therefore, the court found, the Bondholders had a claim on the Net Revenues that derived from their "equitable remed[ies] for breach of performance." *Id.* And the amount of that claim was limited to "[what] could be achieved through the application of the equitable remedies to fulfill the ... covenant to pay the [Revenue] Bonds from the Net Revenues of the System."

*311 [34] That brings us to [section 502\(c\)\(2\) of the Bankruptcy Code](#). Under that section, a court may estimate (i.e., assign a dollar amount to) a "right to payment arising from a right to an equitable remedy for breach of performance." See *id.* § 502(c)(2). Applying [section 502\(c\)](#), the district court estimated the Bondholders' unsecured claim on the Net Revenues at \$2.4 billion. Broadly speaking, the Title III court reached that number by estimating how much Net Revenue a receiver would be able to direct into the Sinking and Subordinate Funds (while complying with the rest of the Trust Agreement) over the next 100 years and then discounting that figure to present value.

2.

We disagree with the foundational assumption of the Title III court's valuation analysis: that the Bondholders' claim on the Net Revenues was a "right to payment arising from a right to an equitable remedy for breach of performance" subject to estimation under [section 502\(c\)\(2\)](#). Instead, we find that the Bondholders had a legal "right to payment" rooted in the covenants outlined in the Trust Agreement. Because the Revenue Bonds specify the amount that PREPA legally owes the Bondholders, there was no need to estimate the Bondholders' "right to payment" under [section 502\(c\)](#).

[35] A creditor holds a "right to payment" when the debtor is legally obligated to pay "under the relevant non-bankruptcy law." *In re Chateaugay Corp.*, 53 F.3d 478, 497 (2d Cir.

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1995) (quoting [In re Nat'l Gypsum Co.](#), 139 B.R. 397, 405 (Bankr. N.D. Tex. 1992)). Here, that non-bankruptcy law is the law of contracts (and the Authority Act) as applied to the Trust Agreement. And the Trust Agreement clearly requires PREPA to pay the bonds in full. In section 701 of the Trust Agreement, PREPA promises to “promptly pay the principal of and interest on each and every bond issued” under the Trust Agreement. This covenant creates a legal right to payment. To be sure, but for the automatic stay on actions against PREPA's estate, the Bondholders could deploy various equitable remedies -- such as receivership -- to enforce their right to payment if PREPA breaches the covenant. See [P.R. Laws Ann. tit. 22, § 208](#). But the underlying right remains a legal one. Indeed, the Trust Agreement expressly permits the Bondholders to proceed at law to challenge any breach of the Trust Agreement's covenants.

[36] When a legal right to payment arises from a debt instrument, the “proper amount of claim in a bankruptcy case” is the “full face amount of [the instrument].” [In re Oakwood Homes Corp.](#), 449 F.3d 588, 596–97 (3d Cir. 2006) (emphasis omitted) (quoting 4 [Collier on Bankruptcy](#) ¶ 502.03 (5th rev. ed. 2005)); see also [In re Trendsetter HR L.L.C.](#), 949 F.3d 905, 910 n.22 (5th Cir. 2020) (citing the same [Collier](#) section).

[37] [38] This makes sense. As an analogy, consider how courts have applied [section 502\(c\)\(1\)](#), another estimation provision that applies to “contingent or unliquidated claim[s].” 11 U.S.C. § 502(c)(1). The purpose of that provision is to assign a dollar amount to “undetermined claims of an unsettled amount.” [In re Trendsetter](#), 949 F.3d at 910 n.22. By contrast, [section 502\(c\)\(1\)](#) does not apply to “liquidated claims” -- that is, claims with an amount determinable “by reference to an agreement or by a simple computation.” [In re Nicholes](#), 184 B.R. 82, 89 (B.A.P. 9th Cir. 1995). When dealing with “liquidated claims,” the court can often look to an underlying agreement to determine the claim amount. [Id.](#) (“[D]ebts arising from a *312 contract are generally liquidated.”); see also [In re Flaherty](#), 10 B.R. 118, 120 (Bankr. N.D. Ill. 1981) (the amount of a liquidated claim “may be ascertained by computation or reference to the contract out of which the claim arises”) (quoting [Zimek v. Ill. Nat'l Cas. Co.](#), 370 Ill. 572, 572, 19 N.E.2d 620 (1939)); 2 [Norton Bankruptcy Law & Practice](#) § 48:13 (3d ed. 2024) (“Liquidated claims ... should be calculated directly from the underlying obligation under applicable law.”).

[39] [40] The case law around [section 502\(c\)\(1\)](#) informs our analysis of [section 502\(c\)\(2\)](#). A claim “arising from a right to an equitable remedy for breach of performance” resembles a “contingent or unliquidated claim.” In both cases, the amount of the claim is not easy to discern, so estimation is appropriate. 11 U.S.C. § 502(c)(1)–(2). But here, the Bondholders' claim resembles a “liquidated claim.” We can easily determine its amount by looking to the contract from which it arises: the Trust Agreement. [In re Flaherty](#), 10 B.R. at 120. According to that contract, the face value of the Revenue Bonds (i.e., the principal plus matured interest) is just under \$8.5 billion.²⁰ So, that is the amount of the Bondholder's claim on the Net Revenues.

Only one party -- AAFAF -- attempts to defend the Title III court's estimation analysis. The agency argues that the Bondholders do not have a contractual right to payment in full, because section 804 of the Trust Agreement permits paying the Bondholders “solely from the Sinking Fund and other moneys available for such purpose.” So, AAFAF argues, the Bondholders only have a right to payment from non-deposited Net Revenues if they deploy their equitable remedies to force those Net Revenues into the Sinking Fund. The upshot of this argument is that any right to payment from the Net Revenues is equitable, not legal.

There are two problems with this argument. First, AAFAF conflates the mechanism by which the Bondholders are paid with the Bondholders' underlying legal right to payment. The fact that payments come from the Sinking Fund says nothing about the Bondholders' underlying entitlement to those payments in the first place. That legal right stems from the payment covenant in section 701, which never states that the Bondholders are only entitled to payment from the Sinking Fund. Second, the text of section 804 undercuts AAFAF's position. That provision permits payment of the Bondholders from the “Sinking Fund and any other moneys available for such purpose.” (Emphasis added.) Net Revenues are “available” for debt service. The only pre-debt service payments required by the Trust Agreement are the deduction of Current Expenses from incoming Revenues, which is required under section 505. After that, Net Revenues are eligible for debt payments, as evidenced by the text of section 804 referring to “other moneys” available for debt service, not “other funds” available for debt service.

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Accordingly, the proper amount of the claim is the principal plus matured interest of the bonds, or roughly \$8.5 billion (the district court can determine the precise amount). Importantly, this is not to say that the Bondholders must be paid \$8.5 billion. Rather, it is to say that the Bondholders' allowed claim on PREPA's estate is on the order of \$8.5 billion. And that allowed claim is only secured "to the extent of the value of [the Bondholders'] interest" in the Net Revenues and the

***313** Sinking and Subordinate Funds. 11 U.S.C. § 506(a)(1). If the value of those liens is less than the allowed claim amount, then the Bondholders are undersecured. In that event, what (if anything) can the Bondholders do to recover the difference between the allowed claim amount and the value of their collateral? We turn to that question next.

B.

[41] In the proceedings below, the parties took opposing positions on whether the Bondholders had any recourse against PREPA beyond their rights to the collateral securing the Revenue Bonds. Given our holding that the Bondholders' collateral does include PREPA's Net Revenues, the significance of this issue has likely shrunk, but not disappeared.

[42] [43] Under [section 1111\(b\) of the Bankruptcy Code](#), a secured creditor -- subject to limited exceptions -- has "recourse against the debtor on account of [its secured] claim," even if the creditor is otherwise nonrecourse under applicable non-bankruptcy law. [Id.](#) § 1111(b)(1)(A). However, under [section 927 of the Bankruptcy Code](#), this presumption of recourse does not apply to a "holder of a claim payable solely from special revenues of the debtor." [Id.](#) § 927.

[44] The Bondholders contend that [section 927](#) does not apply, because their secured claim is not payable "solely" from special revenues. Instead, they claim, the Revenue Bonds are also payable from non-special revenue sources like investment earnings, federal subsidies, or insurance proceeds. This argument overreads the word "solely" in [section 927](#). The purpose of [section 927](#) is to deny special revenue bondholders any recourse to the general funds of a municipality, which are often subject to "statutory or constitutional limits on debt issuance." 6 [Collier on](#)

[Bankruptcy](#) ¶ 927.02 (16th ed. 2024). Thus, a claim is payable "solely from special revenues" under [section 927](#) when the claimant lacks "any right to claim from the general treasury of the municipality." [Id.](#) Here, the Trust Agreement expressly states that the Revenue Bonds are not "general obligations of [the] Commonwealth of Puerto Rico." So, [section 927](#) applies, and the Bondholders' recourse is limited to their collateral unless the Trust Agreement says otherwise.

Nothing in the Trust Agreement makes the Bondholders recourse creditors. The only contractual provisions cited by the Bondholders are sections 804 and 805. Section 804 permits the Bondholders' Trustee to sue PREPA for unpaid moneys and to demand payment from the "Sinking Fund and any other moneys available for [debt service]." As noted above, only the Net Revenues (and the non-Net Revenue moneys in the lienied Funds) are available for debt service. Section 505 of the Trust Agreement requires payment of Current Expenses (i.e., conversion of Revenues to Net Revenues) before any payments may flow to the Bondholders. So, section 804 simply states that the Bondholders may reach the Net Revenues and the lienied Funds to recover unmade payments. It does not grant any further recourse. The same logic applies to section 805, which states that if moneys in the Sinking Fund are insufficient to make debt service payments, the Bondholders may reach the moneys in the Sinking Fund and "any moneys then available or thereafter becoming available for [debt service]." Again, only Net Revenues and the lienied Funds are available for debt service. So again, section 805 does not broaden the Bondholders' recourse beyond their collateral.

[45] Thus, the Bondholders are nonrecourse creditors. A nonrecourse creditor ***314** may "look only to its collateral for satisfaction of its debt and does not have any right to seek payment of any deficiency from a debtor's other assets." [In re 680 Fifth Ave. Assocs.](#), 156 B.R. 726, 732–33 (Bankr. S.D.N.Y. 1993). The Bondholders may not file an unsecured deficiency claim against PREPA, because that claim would naturally reach assets other than the Bondholders' collateral. This conclusion is hardly novel. In fact, it aligns with the standard market practice for special revenue bonds. [See 4 Norton Bankruptcy Law & Practice](#) § 90:13 (3d ed. 2024) ("[S]pecial revenue bonds usually are non-recourse debt [I]n the event of default the bondholders have no claim against the municipality's general fund or other non-pledged revenues

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or assets [B]ondholders assume the risk that the revenues will not be enough to pay the bonds.”).

tit. 22, § 208(a)(2) (emphasis added). As the Title III court properly noted, this language would be unnecessary if PREPA were already a trustee with respect to all moneys received.

VI.

Finally, the Bondholders appeal two related holdings by the Title III court pertaining to PREPA's trust obligations (or lack thereof). First, some of the Bondholders challenge the court's dismissal of their breach of trust claim. Second, they challenge the court's dismissal of their “accounting” claim, which is rooted in the Authority Act's command that PREPA “account as if [it] were the trustee of an express trust” in favor of the Bondholders. [P.R. Laws Ann. tit. 22, § 208\(a\)\(2\)](#).

We affirm the dismissal of the breach of trust claim, but we reverse the dismissal of the accounting claim.

A.

[46] Some of the Bondholders claim that when PREPA received Revenues, it held them in trust for the benefit of the Bondholders. But the Trust Agreement clearly identifies First National City Bank and its successors -- not PREPA -- as Trustee. In response, the Bondholders point to language in section 601 stating, in pertinent part, that all moneys received by PREPA “shall be deposited with a Depositary or Depositaries [and] shall be held in trust.” But nothing in section 601 states that PREPA receives and holds its moneys in trust in the first instance. On the contrary, section 601 -- which is captioned “Deposits constitute trust funds” -- states that “[a]ll moneys deposited with each Depositary, including the Trustee, shall be credited to the particular fund or account to which such moneys belong.” (Emphasis added.) This language shows that the “Trustee” must be a “Depositary,” i.e., a financial institution designated to hold deposits under the Trust Agreement. PREPA is not a Depositary. So, we read section 601 as requiring PREPA to deposit moneys with Depositaries, who then hold the moneys in trust and apply them in accordance with the Trust Agreement. Section 601 does not make PREPA itself a trustee.

The text of the Authority Act elsewhere reinforces our conclusion. The Authority Act requires PREPA to “account as if [it] were the trustee of an express trust.” [P.R. Laws Ann.](#)

B.

[47] The Bondholders also appeal the Title III court's dismissal of their accounting claim. Here, the Bondholders are on firmer footing. We agree that the accounting claim should be reinstated.

The Authority Act permits the Bondholders, subject to the terms of the Trust Agreement, to bring an equitable action requiring PREPA to “account as if [it] ***315** were the trustee of an express trust.” [P.R. Laws Ann. tit. 22, § 208\(a\)\(2\)](#). And the Trust Agreement does not limit this authority. Section 804 permits the Trustee to sue (on the Bondholders' behalf) for “the enforcement of any proper legal or equitable remedy.”

The concept of an “accounting” is not defined in the Trust Agreement, the Authority Act, or Puerto Rico law. Historically, though, an “accounting” has been an equitable remedy much like restitution or disgorgement. [See Liu v. SEC](#), 591 U.S. 71, 79, 140 S.Ct. 1936, 207 L.Ed.2d 401 (2020) (noting that an equitable cause of action to “deprive[] wrongdoers of their net profits from unlawful activity” has been variously called accounting, restitution, or disgorgement).

Taken together, the Trust Agreement and Authority Act appear to permit the Bondholders to bring an equitable action for Net Revenues wrongly diverted from debt service. Indeed, in their brief, the Bondholders suggest that PREPA has spent Net Revenues on unreasonable Current Expenses, thereby starving the Sinking and Subordinate Funds of cash and slowing debt payments to the Bondholders. So, the Bondholders appear to have an accounting claim, unless any relevant authorities suggest otherwise.

In dismissing the accounting claim, the Title III court concluded that a creditor requesting an “accounting” under Puerto Rico law is entitled only to information about the debtor's unpaid obligations. It relied on two authorities for this proposition, but we do not find either one apposite.

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[48] First, the court relied on [P.R. Laws Ann. tit. 19, § 2240](#), which defines a “request for an accounting” as a “record authenticated by a debtor requesting that the recipient provide an accounting of the unpaid obligations secured by collateral.” [P.R. Laws Ann. tit. 19, § 2240\(a\)\(2\)](#). As the text makes clear, this provision concerns a debtor's request for an accounting, not a creditor's request for an accounting. Moreover, the definition of “request for an accounting” that appears in [section 2240](#) is expressly limited to that section. [Id. § 2240\(a\)](#).

Second, the court relied on our holding in [Citibank Global Mkts., Inc. v. Rodríguez Santana](#), 573 F.3d 17 (1st Cir. 2009). There, an account holder sued a broker-dealer, broadly alleging overcharging of commissions. [Id.](#) at 21–22. The account holder alleged the broker-dealer had fraudulently induced him to sign a settlement agreement concerning those overcharges. [Id.](#) at 29. He argued that the settlement would only have been valid if the broker-dealer (acting as his agent) had “provide[d] an accounting of its ... overcharges.” [Id.](#) at 30. The broker-dealer had, in fact, provided a “detailed forty-plus page analysis of the overcharges.” [Id.](#) at 30. The [Citibank](#) court did not pass on whether such an accounting was, in fact, required. It simply held that, if an accounting were required, nothing in Puerto Rico law suggested that the broker-dealer's analysis was insufficient. [Id.](#) Thus, [Citibank](#) did not define the remedy of “accounting” under Puerto Rico law. And even if it did define that remedy, it did so in the context of agency

law, not secured transactions. [Id. Citibank](#) therefore provides little guidance here.

To conclude, the Bondholders have properly pled a claim for an equitable accounting. That said, we emphasize, as the Board correctly does, that any equitable accounting will not expand the Bondholders' recourse beyond the Net Revenues. Under the Authority Act, a claim for an equitable accounting is subject to the terms of the Trust Agreement. *316 [P.R. Laws Ann. tit. 22, § 208\(a\)](#). And as discussed above, sections 804 and 805 of the Trust Agreement state that in any legal or equitable action to enforce payment of the Revenue Bonds, the Bondholders may only reach moneys available for debt service. Thus, while the Bondholders stated a claim for an accounting under the Authority Act, that claim will not entitle them to reach any moneys or funds in which they do not already hold a security interest.

VII.

For the foregoing reasons, the judgment of the Title III court is affirmed in part and reversed in part. All parties shall bear their own costs.

All Citations

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Footnotes

- * Of the Southern District of New York, sitting by designation.
- 1 The current trustee is U.S. Bank National Association (to which we refer as the “Trustee”).
- 2 The lower-case phrase “the bondholders” refers generally to the creditors that loaned PREPA money under the Trust Agreement. When specifically discussing the bondholders and insurers that are parties in this action, we use the capitalized term “Bondholders.”
- 3 The Bondholders propose different labels for this provision, such as the “Now, Therefore paragraph,” or the “Granting Clause.” While we opt for the simpler “Preamble,” our choice of label does not bear on whether the provision is operative or prefatory.

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- 4 The Trust Agreement carved out several forms of investment income from this definition. Those exceptions are not relevant to this case, so we do not detail them here.
- 5 This excludes investment income, certain types of which qualify as “Revenue” but nevertheless do not flow into the General Fund.
- 6 The Construction Fund is not technically part of the waterfall structure established in Article V. Instead, the Construction Fund is replenished by bond proceeds and certain Net Revenues preemptively siphoned off from the Revenue Fund. For the sake of simplicity, however, we include it in the broader category of Subordinate Funds.
- 7 Sections 401 and 507 both grant a lien to the Trustee, not the bondholders. But those sections confirm that this lien is for the benefit of the bondholders.
- 8 The parties have since stipulated that the Bondholders' security interests in the Reserve Maintenance Fund, the Capital Improvement Fund, and the Construction Fund are unperfected. Joint Stipulation & Proposed Agreed Order of the Financial Oversight and Management Board for Puerto Rico, U.S. Bank National Ass'n as PREPA Bond Trustee, the Ad Hoc Group of PREPA Bondholders, Assured Guaranty Corp., Assured Guaranty Municipal Corp., National Public Finance Guarantee Corp., and Syncora Guarantee, Inc. Resolving Perfection-Related Issues at 5–7, [In re Fin. Oversight & Mgmt. Bd. for P.R.](#), 703 F. Supp. 3d 318 (D.P.R. 2023) (Adv. Proc. No. 19-00391). There is one notable exception to this stipulation: The Bondholders may still argue that they have a perfected security interest in PREPA's Revenues, and that this perfection extends to the moneys in these Subordinate Funds. [Id.](#)
- 9 In our analysis, we frequently refer to arguments made by the Bondholders. In their briefing, several Bondholders -- specifically, GoldenTree Asset Management LP, Syncora Guarantee, and U.S. Bank National Association -- incorporate by reference arguments made by other Bondholders, pursuant to [Federal Rule of Appellate Procedure 28\(i\)](#). The PREPA Ad Hoc Group does not do so. But neither the Board nor its allies suggests that the Bondholders' invocation of [Rule 28\(i\)](#) was improper, or that the PREPA Ad Hoc Group's failure to invoke [Rule 28\(i\)](#) constitutes waiver of arguments raised exclusively by other Bondholders. So, where a Bondholder sufficiently develops a given argument, we attribute that argument to all “the Bondholders.”
- 10 The full text of the Preamble reads:

Now, Therefore, This Agreement Witnesseth, that in consideration of the premises, of the acceptance by the Trustee of the trusts hereby created, and of the purchase and acceptance of the bonds by the holders thereof, and also for and in consideration of the sum of One Dollar to the Authority in hand paid by the Trustee at or before the execution and delivery of this Agreement, the receipt of which is hereby acknowledged, and for the purpose of fixing and declaring the terms and conditions upon which the bonds are to be issued, executed, authenticated, delivered, secured and accepted by all persons who shall from time to time be or become holders thereof, and in order to secure the payment of all the bonds at any time issued and outstanding hereunder and the interest and the redemption premium, if any, thereon according to their tenor, purport and effect, and in order to secure the performance and observance of all the covenants, agreements and conditions therein and herein contained, the Authority has executed and delivered this Agreement and has pledged and does hereby pledge to the Trustee the revenues of the System, subject to the pledge of such revenues to the payment of the principal of and the interest on the 1947 Indenture Bonds (hereinafter mentioned), and other moneys to the extent provided in this Agreement as security for the payment of the bonds and the interest and the redemption premium, if any,

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thereon and as security for the satisfaction of any other obligation assumed by it in connection with such bonds, and it is mutually agreed and covenanted by and between the parties hereto, for the equal and proportionate benefit and security of all and singular the present and future holders of the bonds issued and to be issued under this Agreement, without preference, priority or distinction as to lien or otherwise, except as otherwise hereinafter provided, of any one bond over any other bond, by reason of priority in the issue, sale or negotiation thereof or otherwise, as follows:

- 11 Under section 1301 of the Trust Agreement, Puerto Rico law governs the contract's construction.
- 12 The Bondholders also reference section 701's statement that the "Revenues are hereby pledged to the payment of [the Revenue Bonds]." Our analysis applies to that language as well.
- 13 Sections 516(c) and 705 use this language, while section 712 describes a lien on the "Revenues of the bonds issued under and secured by this Agreement."
- 14 The parties disagree on whether other categories of moneys -- such as letters of credit and federal subsidies -- also qualify as Net Revenues. We need not resolve that issue here.
- 15 "Special revenues" include "receipts derived from the ownership, operation, or disposition of projects or systems of the debtor that are primarily used ... to provide transportation, utility, or other services, including the proceeds of borrowings to finance the projects or systems." 11 U.S.C. § 902(2)(A). The parties agree that PREPA's Net Revenues are "special revenues."
- 16 Broadly, under section 552(b)(1), a creditor maintains a post-petition lien on the "proceeds" of collateral acquired pre-petition. 11 U.S.C. § 552(b)(1). The bondholders in [Andalusian](#) argued that post-petition employer contributions were "proceeds" of collateral they had acquired pre-petition (i.e., ERS's right to receive employer contributions). See 948 F.3d at 466.
- 17 The applicable provision defined "payment intangibles" as a form of "general intangible." [Ocean Dev.](#), 447 B.R. at 732 n.4.
- 18 The language of the financing statement seems to imply that the Bondholders' lien is in Revenues, rather than Net Revenues. But under Commonwealth law, the financing statement cannot create an interest beyond that created by the Trust Agreement. See [Xynergy Healthcare Cap. II LLC v. Municipality of San Juan](#), 516 F. Supp. 3d 137, 155–56 (D.P.R. 2021) ("Where a security agreement covers only certain assets, the financing statement's inclusion of additional assets is ineffective to create a security interest in the additional assets omitted from the security agreement." (quoting [In re Levitz Ins. Agency](#), 152 B.R. 693, 698 (Bankr. D. Mass. 1992))).
- 19 As noted earlier, see [supra](#) note 8, the Bondholders have reserved the right to argue that perfection of the lien on Net Revenues also perfects the liens on moneys deposited into certain Funds. Because the district court had no opportunity to rule on this issue, and because we have not received focused briefing on it, we offer no opinion on whether -- or to what extent -- perfection of the Net Revenue lien influences perfection of the liens in the Sinking and/or Subordinate Funds.
- 20 For our purposes, the face value of a debt instrument is the principal plus any matured interest. The bankruptcy court must disallow any portion of a claim attributable to unmatured interest. See 11 U.S.C. § 502(b)(2).

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In re Soussis, 136 F.4th 415 (2025)

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United States Court of Appeals, Second Circuit.

IN RE: Julia F. SOUSSIS, Debtor
Julia F. Soussis, Appellant,

v.

Michael J. Macco, Chapter 13
Trustee, and U.S. Trustee, Appellees.

Docket No. 22-155

|

August Term, 2022

|

Argued: February 15, 2023

|

Decided: May 9, 2025

Synopsis

Background: Debtor filed for Chapter 13 bankruptcy, proposed a repayment plan, and made pre-confirmation payments to the standing trustee. Before the bankruptcy court held a hearing on whether to confirm the plan, debtor moved to dismiss her case. The bankruptcy court granted the motion. The standing trustee returned most of debtor's pre-confirmation payments but kept a percentage as a fee. The United States Bankruptcy Court for the Eastern District of New York, [Robert E. Grossman, J., 624 B.R. 559](#), denied debtor's motion for disgorgement of the fee. Debtor appealed. The United States District Court for the Eastern District of New York, [Joan M. Azrack, J., 2022 WL 203751](#), affirmed. Debtor appealed.

[Holding:] The Court of Appeals, Carney, Senior Circuit Judge, held that on issue of first impression, standing trustees may not keep a percentage of the debtor's pre-confirmation payments as a fee if no plan is confirmed.

Reversed and remanded.

Procedural Posture(s): On Appeal.

West Headnotes (21)

[1] **Bankruptcy** 🗝️ Individual Debt Adjustment Cases

Bankruptcy 🗝️ Completion of plan; hardship

Chapter 13, which allows debtors to keep most of their property while in bankruptcy proceedings, is available to individuals with regular income who owe less than a specified amount, currently \$526,700 for unsecured debts and \$1,580,125 for secured debts, and debtors ultimately secure a discharge of their debts if they propose and abide by a court-approved plan to use their future income to repay creditors in installments over a three- to five-year period. [11 U.S.C.A. §§ 101\(30\), 104\(a\), 109\(e\), 1306\(b\), 1321, 1322\(a\)\(1\), 1327\(b\)](#).

[2] **Bankruptcy** 🗝️ Effect; proceedings in converted case

If a Chapter 13 bankruptcy plan is confirmed but the case is later dismissed or converted, the debtor cannot recover any payments she has made that previously have been distributed to creditors.

[3] **Bankruptcy** 🗝️ Record; assignments of error; briefs

Chapter 13 debtor abandoned issue, raised on claim under Federal Tort Claims Act seeking to recover her attorney's fees as damages, of whether standing bankruptcy trustee breached his fiduciary duty to her when he collected his percentage fees from pre-confirmation payments, since debtor did not brief issue on appeal of denial of her motion for disgorgement of fee. [11 U.S.C.A. § 1326; 28 U.S.C.A. §§ 586, 1346, 2671 et seq.](#)

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[4] **Federal Courts** 🗝️ [Statutes, regulations, and ordinances, questions concerning in general](#)
Questions of statutory interpretation are reviewed de novo.

[5] **Statutes** 🗝️ [Plain Language; Plain, Ordinary, or Common Meaning](#)
On questions of statutory interpretation, a court starts, as always, by examining the text of the relevant statutory provisions to discern their plain meaning.

[6] **Statutes** 🗝️ [Dictionaries](#)
Plain meaning of statute is informed by, but does not depend solely on, dictionary definitions.

[7] **Statutes** 🗝️ [Context](#)
To ascertain a text's plain meaning, court draws on the specific context in which that language is used, and the broader context of the statute as a whole.

[8] **Statutes** 🗝️ [Plain, literal, or clear meaning; ambiguity](#)
If statutory text is unclear, court may consult the legislative history to discern the legislative purpose as revealed by the history of the statute.

[9] **Bankruptcy** 🗝️ [Trustees](#)
Bankruptcy 🗝️ [Effect](#)
Standing bankruptcy trustees may not keep a percentage of the Chapter 13 debtor's pre-confirmation payments as a fee if no plan is confirmed; under such circumstances, the standing trustee must return any percentage fee that he has collected because word "payments" under the statute governing payments covers all of the debtor's obligations, including the trustee's

fee, the payment statute does not permit the standing trustee to deduct his percentage fee before he returns payments to the debtor, and barring the trustee from retaining a fee when a plan is not confirmed is consistent with the policy goals underlying Chapter 13. [11 U.S.C.A. § 1326](#); [28 U.S.C.A. § 586](#).

[10] **Bankruptcy** 🗝️ [Trustees](#)
Bankruptcy 🗝️ [Effect](#)

The payment statute does not contemplate payment of standing bankruptcy trustee's percentage fee if confirmation never happens because Chapter 13 trustee will never pay creditors if no plan is confirmed, and statute provides for payment of trustee fees before or at time trustee pays creditors. [11 U.S.C.A. § 1326\(b\)](#).

[11] **Statutes** 🗝️ [Relative and qualifying terms and provisions, and their relation to antecedents](#)
The "last antecedent rule" posits that a limiting clause or phrase ordinarily should be read as modifying only the noun or phrase that it immediately follows.

[12] **Statutes** 🗝️ [Exceptions, Limitations, and Conditions](#)
The "series qualifier canon" posits that a modifier at the beginning or end of a series of terms modifies all the terms.

[13] **Statutes** 🗝️ [Relative and qualifying terms and provisions, and their relation to antecedents](#)
Statutes 🗝️ [Exceptions, Limitations, and Conditions](#)
The series qualifier canon of statutory construction generally prevails over the last antecedent rule when there is no reason consistent with any discernible purpose of the statute to apply the limiting phrase to the last

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antecedent alone; the series qualifier canon has particular force if the statute includes nouns or verbs in a series, such as “previously paid” and “due and owing.”

[14] Bankruptcy ➡ Effect; proceedings in converted case

Payments in the amount proposed by the Chapter 13 bankruptcy plan under the payment statute refers to the entire sum of the pre-confirmation payment, including the amounts intended to cover the trustee's percentage fees; the statute does not authorize the trustee to deduct an amount for the percentage fee. 11 U.S.C.A. § 1326(a)(2).

[15] Bankruptcy ➡ Trustees
Bankruptcy ➡ Effect

The statute setting forth, in general terms, the source of the standing bankruptcy trustee's compensation does not direct when the percentage fee should be collected, what should happen after the fee is collected, or whether the fee must be returned if the plan is not confirmed. 28 U.S.C.A. § 586(e)(2).

[16] Bankruptcy ➡ Administration; debtor's status; appointment of trustee

In preconfirmation period, Chapter 13 debtor must propose bankruptcy plan and begin making payments under plan, including in those payments amount sufficient to cover standing trustee's percentage fee.

[17] Bankruptcy ➡ Trustees
Bankruptcy ➡ Effect

Congress intentionally did not add an explicit provision allowing the standing bankruptcy trustee to deduct his percentage fee from the payments that must be returned to debtors when a Chapter 13 plan is not confirmed, for purpose

of construing payment statute; although closely related statutes were enacted in different years, Congress modeled subsequent provisions on pre-existing provision and it chose to add provision to each section explicitly allowing for deduction of the trustee's fee without clearly stating that it wished to allow standing trustees to deduct the percentage fee before returning Chapter 13 pre-confirmation payments. 11 U.S.C.A. §§ 1194(a), 1226(a), 1326(a)(2).

[18] Bankruptcy ➡ Trustees

The percentage fee system does not compensate standing bankruptcy trustees based on the time devoted to, or any other aspect of the quality or quantity of work done, on a particular Chapter 13 case; rather, the amount of the percentage fee that the trustee is authorized to “collect” turns simply on the amount of a debtor's actual payments to creditors. 28 U.S.C.A. § 586.

[19] Bankruptcy ➡ Trustees

Congress did not create a fee-for-service system for standing bankruptcy trustees, as it did for ad hoc trustees; the percentage fee protocol ensures that the standing trustee receives reasonable compensation in any given year from all of the many cases that he administers, not from any single case. 11 U.S.C.A. § 330(a)(1); 28 U.S.C.A. § 586.

[20] Bankruptcy ➡ Good faith in general

The requirement for the Chapter 13 debtor to make pre-confirmation payments, in and of itself, deters bad faith filings; allowing courts to dismiss bankruptcy cases or deny confirmation based on evidence of bad faith, or to deny return of the debtor's property post-dismissal “for cause” also discourages bad faith filings. 11 U.S.C.A. §§ 349(b)(3), 362(c)(3), 1307, 1325(a)(3).

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[21] **Constitutional Law** **Policy**

Congress, not the courts, strikes the balance between competing policy priorities.

Attorneys and Law Firms

***418** [Jeffrey Herzberg](#), Jeffrey Herzberg, P.C., Hauppauge, NY, for Appellant.

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Tara Twomey, National Consumer Bankruptcy Rights Center, San Jose, CA, for Amici Curiae, National Consumer Bankruptcy Rights Center and National Association of Consumer Bankruptcy Attorneys, in support of Appellant.

[Henry E. Hildebrand, III](#), Chapter 13 Standing Trustee; [James M. Davis](#), Staff Attorney, Nashville, TN, for Amici Curiae, National Association of Chapter Thirteen Trustees, in support of Appellees.

Before: [Sack](#), Carney, and Bianco, Circuit Judges.

Opinion

Carney, Circuit Judge:

In this bankruptcy appeal, Debtor-Appellant Julia Soussis challenges the lower courts' determination that the standing trustee in a Chapter 13 bankruptcy proceeding is paid his statutory percentage fee when a case is dismissed before a repayment plan is approved ("confirmed") by the court.

Two federal statutory provisions are most critical to resolving this appeal: [Section 1326 of title 11](#), which governs a debtor's payments before a plan is confirmed, and [Section 586 of title 28](#), which establishes the compensation scheme for standing trustees. Under [Section 1326\(a\)\(1\)](#), debtors in Chapter 13 cases must file a ***419** proposed plan of repayment and begin making payments to the trustee supervising the case in accordance with that proposed plan. [Section 1326\(a\)\(2\)](#) instructs the trustee to "retain" the pre-confirmation payments until the confirmation hearing, when the proposed plan is either confirmed or confirmation is denied. If a plan is confirmed, the trustee must then "distribute any such [preconfirmation] payment[s] in accordance with the plan[.]" 11 U.S.C. § 1362(a)(2). If confirmation of the plan is denied, on the other hand, the trustee is required to "return any such [pre-confirmation] payments ... to the debtor," after deducting administrative expenses that do not include the standing trustee's fee. *Id.* Section 586 directs the Attorney General to fix a percentage fee for standing trustees and provides that the standing trustee "shall collect" that fee "from all payments received ... under" any Chapter 13 plans administered by the trustee. 28 U.S.C. § 586(e)(2). The percentage in question is applied to each payment that the debtor makes under a Chapter 13 plan.

In the proceedings before the Bankruptcy Court, Soussis filed for Chapter 13 bankruptcy, proposed a repayment plan, and made \$362,100 in pre-confirmation payments to the standing trustee administering her case. As required by [Section 1326\(a\)\(2\)](#), the standing trustee "retained" those payments pending confirmation of her proposed plan. Before the Bankruptcy Court held a hearing on whether to confirm the plan and before any debts were discharged, however, Soussis asked the court to dismiss her case. The standing trustee returned most of Soussis's \$326,100 in pre-confirmation payments to her, as directed by [Section 1326\(a\)\(2\)](#), but he kept \$20,592 (5.7%) for his percentage fee as compensation for services rendered. The Bankruptcy Court denied Soussis's motion for disgorgement of that sum, and the District Court affirmed. Soussis now appeals.

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On *de novo* review, we join the Seventh, Ninth, and Tenth Circuits in holding that a standing trustee cannot keep any percentage fee he collects from the debtor's pre-confirmation payments if no plan is confirmed. Section 1326(a)(2) directs the trustee to return the "payments ... proposed by the plan." 11 U.S.C. § 1326(a)(1)–(a)(2). Because the percentage fee is collected from—and therefore included in—the payments "proposed by the plan," it too must be returned. Further, in bankruptcies under Chapter 11 (Subchapter V) and Chapter 12, Congress has expressly permitted the standing trustee to deduct his percentage fee before returning pre-confirmation payments to the debtor when a plan is not confirmed. It nevertheless has not enacted language authorizing the same deduction for Chapter 13 plans. Finally, we are not persuaded that a different result is mandated by Section 586(e)(2), which provides that the standing trustee "shall collect" his percentage fee from "all payments received" under the Chapter 13 plans he administers. To "collect" the percentage fee could reasonably be understood to mean to "collect and keep it" or to "collect and hold it provisionally"; alternatively, to "collect" from could simply identify the source of a likely eventual payment. We therefore consider the word "collect" ambiguous as used in Section 586.

Reading Section 586 in light of Section 1326, however, resolves the ambiguity: the trustee may "collect" the percentage fee from pre-confirmation payments, 28 U.S.C. § 586(e)(2), but he must "retain[]" it before the confirmation hearing, and "return" it if no plan is confirmed, 11 U.S.C. § 1326(a)(2). We conclude that this interpretation best comports with the texts of both statutes and best aligns with the trustee *420 compensation scheme established by Congress.

We therefore REVERSE the judgment of the District Court and REMAND the case for further proceedings consistent with this opinion.

BACKGROUND

I. Statutory background

A. Chapter 13: wage-earner bankruptcy

[1] Chapter 13 of the Bankruptcy Code provides many wage-earners an alternative to Chapter 7 bankruptcy proceedings. Both offer a court-supervised route to financial recovery, but Chapter 13 is available only to "individual[s] with regular

income" who owe less than a specified amount (currently \$526,700 for unsecured debts and \$1,580,125 for secured debts).¹ 11 U.S.C. §§ 109(e), 104(a), 101(30); *Adjustment of Certain Dollar Amounts Applicable to Bankruptcy Cases*, 90 Fed. Reg. 8941 (Feb. 4, 2025). The Chapter 13 framework allows debtors to keep most of their property while in bankruptcy proceedings. 11 U.S.C. §§ 1306(b), 1327(b). Chapter 13 debtors can ultimately secure a discharge of their debts if they propose and abide by a court-approved plan to use their future income to repay creditors in installments over a three- to five-year period. *Id.* §§ 1321, 1322(a)(1); *see Harris v. Viegelahn*, 575 U.S. 510, 513–14, 135 S.Ct. 1829, 191 L.Ed.2d 783 (2015). Chapter 13 bankruptcy thus provides an attractive option for the debtor who, as a wage-earner, can reasonably commit to making regular payments from her future income.

To initiate a Chapter 13 proceeding, the debtor files a petition and submits sworn statements disclosing her assets, liabilities, income, expenses, and other pertinent information. *See* 11 U.S.C. § 301; *Fed. R. Bankr. P.* 1007. Key here, within 14 days after filing, the debtor must submit her written proposed plan for repaying all or part of her debts. *See* 11 U.S.C. §§ 1321–22; *Fed. R. Bankr. P.* 3015(b); *see also* U.S. Courts, Official Form 113: Chapter 13 Plan ("Official Form 113"), <https://perma.cc/7JQB-S6S8>. After the required materials are submitted, the presiding Bankruptcy Court judge reviews the proposed plan. If the court finds that it meets the statutory requirements, the plan will be confirmed and will then bind the debtor and her creditors. *See* 11 U.S.C. §§ 1325, 1327. If the judge does not confirm the plan, he may dismiss the case, convert the case to a proceeding under Chapter 7, or permit the debtor to propose an amended plan. *Id.* §§ 1307(c), 1323(a).

Until 1978, bankruptcy judges handled both the judicial and administrative tasks (including trustee appointment) arising from a given case. *See Siegel v. Fitzgerald*, 596 U.S. 464, 468, 142 S.Ct. 1770, 213 L.Ed.2d 39 (2022). Under the current system, which was piloted in 1978 and later expanded to nearly all parts of the United States in 1986, a trustee is assigned to administer a Chapter 13 plan. *Id.* at 468–69, 142 S.Ct. 1770; *see* 28 U.S.C. § 586; 11 U.S.C. § 1302. The Chapter 13 trustee's responsibilities include, *inter alia*, managing the collection of funds and payment of debts in a case—both before and after plan confirmation.

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Once the Chapter 13 proceedings are underway and a trustee has been appointed, the debtor retains the authority to ***421** modify the proposed plan, including in response to objections by the trustee or creditors. [11 U.S.C. § 1323\(a\)](#). The debtor may also convert her case to a Chapter 7 proceeding (requiring the liquidation of most assets) or request that the court dismiss her Chapter 13 proceedings altogether. *Id.* § 1307(a)–(b).

Unless the court orders otherwise, a Chapter 13 debtor must begin making payments to the trustee under the proposed plan within “30 days after the date of the filing of the plan or the order for relief, whichever is earlier[.]” *Id.* § 1326(a)(1). “Order for relief” is a term of art in the Bankruptcy Code: as relevant here, an “order for relief” occurs when a debtor first files a Chapter 13 case or when an earlier case proceeding under another chapter is converted to one under Chapter 13. *Id.* §§ 301(b), 348(a). Thus, [Section 1326\(a\)\(1\)](#) “effectively requires payments to commence within 30 days after the petition or conversion to [C]hapter 13.” 8 Collier on Bankruptcy ¶ 1326.02[1] (16th ed. 2025).

The confirmation hearing must begin no more than 95 days (approximately three months) after the debtor's initial filing of the petition. [11 U.S.C. § 1324\(b\)](#) (“The hearing on confirmation of the plan may be held ... not later than 45 days after the date of the meeting of creditors[.]”); [Fed. R. Bankr. P. 2003\(a\)\(1\)\(C\)](#) (specifying that a meeting of the creditors must be held “no more than 50 days after the order for relief”); *see also* 8 Collier ¶ 1324.02[2] (noting that [Section 1324\(b\)](#) does not require that the court *complete* the confirmation hearing within any particular timeframe and that, “[i]n any event, there are no apparent consequences if the confirmation hearing is not held by the deadline stated in [S]ection 1324(b)”). When no objection to the plan is filed, the bankruptcy court must confirm the plan upon a finding that it meets the criteria set forth in [Section 1325\(a\) of title 11](#).²

If a Chapter 13 plan is confirmed, it binds the debtor and her creditors. *See* [11 U.S.C. § 1327\(a\)](#). Upon confirmation, the trustee must start distributing funds received from the debtor to creditors “as soon as is practicable.” *Id.* § 1326(a)(2). And, subject to only limited exceptions, the court will “grant the debtor a discharge of all debts provided for by the plan” after she has made all of the contemplated payments. *Id.* § 1328(a).

The path to discharge under Chapter 13 is not always smooth, however. As the Supreme Court observed in 2015, many debtors “fail to complete a Chapter 13 plan successfully” despite the significant potential benefits of the program. [Harris](#), 575 U.S. at 514, 135 S.Ct. 1829. A 2017 study found that, of a sample of Chapter 13 cases filed in 2007, only one in three cases ended in discharge: 18.3 percent were dismissed or converted before confirmation, and another 44.2 percent were dismissed or converted after confirmation. *See* Sara S. Greene, Parina Patel, & Katherine Porter, [Cracking the Code: An Empirical Analysis of Consumer Bankruptcy Outcomes](#), 101 Minn. L. Rev. 1031, 1043 (2017). According to recently published data, of all Chapter 13 cases closed in 2023, approximately one-half were closed because the debtor completed payments and the debt was discharged; the remaining half were closed for other reasons, including because the debtor failed to make payments. *See* ***422** Table BAPCPA 6 – Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”) (Dec. 31, 2023), U.S. Courts, <https://perma.cc/78RC-2BVN>.

It thus appears that, while many prospective Chapter 13 debtors’ plans will be confirmed and their creditors will receive some repayment, debtors frequently fall short and are unable to obtain a discharge order.³

B. Appointment and duties of trustees

U.S. Trustees are appointed by the U.S. Attorney General to five-year terms. [28 U.S.C. § 581\(b\)](#). Each U.S. Trustee is charged with administering the federal bankruptcy system in one of twenty-one defined regions in the United States and its territories. *Id.* § 581(a).

When the number of Chapter 13 cases in a region so warrants, the cognizant U.S. Trustee may appoint and will supervise one or more “standing trustees” to handle those cases. [28 U.S.C. § 586\(b\)](#); *see* 1 Collier ¶ 6.01[2][c]. If the volume of cases does not warrant appointing a standing trustee, the U.S. Trustee may instead appoint a qualified individual to serve as trustee in each particular Chapter 13 matter (an “ad hoc” Chapter 13 trustee). [11 U.S.C. § 1302\(a\)](#). The U.S. Trustee himself may also serve as trustee in a Chapter 13 case. *Id.*; [28 U.S.C. § 586\(a\)\(2\)](#). “In practice, all or virtually all [C]hapter 13 cases are handled by standing trustees[.]” and ad hoc trustees are appointed only rarely. 8 Collier ¶ 1302.01.

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[2] Chapter 13 trustees (whether standing, ad hoc, or a U.S. Trustee) perform many duties in Chapter 13 cases, including accounting for all property received from the debtor under the plan; investigating the debtor's financial affairs; examining proofs of claims filed by creditors; and objecting to those proofs on behalf of the debtor, if necessary. 11 U.S.C. § 704(a)(2), (a)(4)–(a)(5); *id.* § 1302(b)(1). The trustee must also oppose the debtor's discharge, if he deems opposition advisable, and must appear and be heard at any hearing that concerns confirmation or modification of a plan. *Id.* §§ 704(a)(6), 1302(b)(2). He assists the debtor with performing the plan; coordinates and disposes of the funds received or to be received in the case; and files a final report and accounting of the administration of the bankruptcy estate when it is ready to be closed. *Id.* §§ 704(a)(9), 1302(b)(3)–(4). The trustee may also move to dismiss or convert the case if the debtor fails to make payments or is in material default. 11 U.S.C. § 1307(c).⁴ See generally Dep't of Justice, *423 Handbook for Chapter 13 Standing Trustees, at pp. 1-2 to 1-3 (effective Oct. 1, 2012), <https://perma.cc/D7LC-DA8J> (summarizing trustee's responsibilities).

C. Compensation of standing and ad hoc trustees

Congress has established separate statutory schemes for the compensation of standing trustees and ad hoc trustees.

Standing trustees collect a “percentage fee” from the payments that debtors make in Chapter 11 (Subchapter V), Chapter 12, and Chapter 13 bankruptcy cases. 28 U.S.C. § 586(e)(2).⁵ The trustee may collect the percentage fee only from those payments that the trustee receives and distributes, and not from payments that the debtor makes directly to creditors. *Id.*; see also 11 U.S.C. § 1326(c) (creating default rule that the trustee disburses payments under a Chapter 13 plan).

Each fiscal year, the Director of the Executive Office for U.S. Trustees (the “Director”) fixes the exact percentage figure—not to exceed ten percent—that is used by each standing trustee to calculate his fee. 28 U.S.C. § 586(e)(1), (e)(1)(B)(i); see Handbook for Chapter 13 Standing Trustees at p. 2-3 (noting that the Attorney General has delegated the authority to choose the percentage fee to the Director). The percentage is selected “with a view to generating sufficient funds with

which to defray the salary and the actual, necessary expenses of the standing Chapter 13 trustee.” 8 Collier ¶ 1302.05[1] [a] (citing H.R. Rep. No. 95-595, at 106 (1978)). To that end, standing trustees each individually submit an annual proposed budget that the Director uses to set that trustee's percentage fee for the year. See Handbook for Chapter 13 Standing Trustees at p. 6-1. Adjustments are possible: if during the fiscal year any trustee discovers that he has overestimated or underestimated his expenses or the payments he will receive for that year, he may ask the Director to amend his budget and increase or decrease the percentage fee that he may collect during the remainder of the year. See *id.* at pp. 6-1 to 6-2; Chapter 13 Practice & Procedure § 17:5; 28 C.F.R. § 58.11(a)(1), (c)(2).

The standing trustee's “actual compensation”—the total amount he collects in fees in a fiscal year for all cases he administers minus reasonable expenses⁶—is subject to two limits. First, actual compensation cannot exceed five percent of “all payments [the trustee] received under [the] plans” that he administers. 28 U.S.C. § 586(e)(2)(A). Second, it cannot exceed the *424 sum of (1) the “highest annual rate of basic pay in effect for level V of the Executive Schedule,” plus (2) the cash value of the employment benefits received by government employees for that base pay level. *Id.* § 586(e)(1)(A); see Salary Table No. 2025-EX, Rates of Basic Pay for the Executive Schedule (EX), Off. of Pers. Mgmt (effective Jan. 2025), <https://perma.cc/M5SC-FBM5>. At the end of the fiscal year, if his “actual compensation” exceeds either of these caps, he must deposit the excess in the U.S. Trustee System Fund, 28 U.S.C. § 586(e)(2)(A)–(e)(2)(B), which covers certain operational expenses for the trustee system, *id.* § 589a. See note 5, *supra*.

In fiscal years 2023 and 2024, almost all Chapter 13 standing trustees received actual compensation at a level at or very near the year's statutory maximum (\$253,705 and \$269,444, respectively). See U.S. Dep't of Just., Chapter 13 Trustee Data and Statistics, available at <https://www.justice.gov/ust/private-trustee-data-statistics/chapter-13-trustee-data-and-statistics> (last visited Apr. 24, 2025). Accounting for expenses, the trustees deposited \$0 in the U.S. Trustee System Fund each year. *Id.* As this data reflects, “standing trustees rarely collect excess funds” because the U.S. Trustee for the region “monitor[s] each standing trustee's income and expenses closely throughout

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the fiscal year,” and “[i]f excess funds are projected, the percentage fee is adjusted downward.” 1 Collier ¶ 6.15[5]. This system ensures that the standing trustee receives adequate, but not excessive, compensation and that his administrative costs are covered.

Because compensation of a standing trustee is based on a percentage of payments received, 28 U.S.C. § 586(e), the total amount he receives in each case depends on the amount of the debt at issue in that case. It is calculated and paid without regard to the amount of time or effort expended on that case. Thus, if the debtor makes large monthly payments, the trustee will collect a sizable fee whether he spends much or little time in administering that debtor's plan.

For an ad hoc trustee appointed to a single case under 11 U.S.C. § 1302, in contrast, the fee is based at least in part on the extent of the trustee's efforts in that particular case. Thus, for such a trustee, the bankruptcy court may award a fee that includes “reasonable compensation” for “actual, necessary” services rendered, plus reimbursement for expenses incurred. 11 U.S.C. §§ 330(a)(1)(A)–(a)(1)(B), 326(b). When determining the compensation award, the court must consider “the nature, the extent, and the value of [the trustee's] services,” weighing factors such as the time the ad hoc trustee spent on the case and the trustee's qualifications. *Id.* § 330(a)(3). Compensation for the ad hoc trustee's services cannot exceed “five percent [of] all payments under the plan.” *Id.* § 326(b). The ad hoc trustee's fee is considered an “administrative expense” under Section 503(b) and accordingly merits “priority” payment. *Id.* §§ 503(b)(2), 507(a)(2).

Both the standing trustee's percentage fee and the ad hoc trustee's fee (along with other Section 503(b) administrative expenses) are to be paid “[b]efore or at the time of each payment to creditors under the plan.” *Id.* § 1326(b); *see id.* §§ 507(a)(2), 503(b)(2). Each fee is also subject to the same statutory minimum: “[u]nless the court orders otherwise,” the trustee's compensation in a Chapter 13 case cannot be “less than \$5 per month from any distribution under the plan during the administration of the plan.” *Id.* § 330(c).

II. Factual and Procedural Background

The underlying facts are not disputed. They are as follows.

*425 A. The Bankruptcy Court proceedings

In May 2007, JPMorgan Chase Bank, N.A. (the “Bank”) sued Debtor-Appellant Julia Soussis in New York State court, seeking to foreclose on a mortgage encumbering Soussis's residence in Garden City, New York. *See JPMorgan Chase Bank, N.A. v. Soussis*, 165 A.D. 3d 1240, 1240–41, 84 N.Y.S.3d 805 (2d Dep't 2018). By November 2008, Soussis had not answered the complaint, and in light of that failure, the state court entered a default judgment in favor of the Bank and authorized the foreclosure sale of Soussis's residence. *Id.* at 1241, 84 N.Y.S.3d 805.

On February 23, 2009, one day before the scheduled foreclosure sale, Soussis filed her first petition for Chapter 13 bankruptcy. When a debtor files for bankruptcy, bankruptcy law generally stays all judicial or administrative actions against her, including state foreclosure actions. *See* 11 U.S.C. § 362(a). Accordingly, the foreclosure sale was cancelled.

Over the next decade, Soussis repeatedly forestalled the sale of her home by bringing multiple (and ultimately unsuccessful) challenges to the state court judgment and also by filing successive Chapter 13 bankruptcy petitions. She filed five bankruptcy petitions between 2009 and 2015, each of which was dismissed—upon a motion from the standing trustee—within three to six months after her filing and before any Chapter 13 plan was confirmed.⁷

In May 2019, Soussis again petitioned the Bankruptcy Court for relief under Chapter 13. By then, Soussis had made no mortgage payments at all for over twelve years. She was \$454,797.33 in arrears on her mortgage. The May 2019 petition was her sixth petition since entry of the 2008 state court default judgment mentioned above.

In June 2019, Soussis submitted her proposed Chapter 13 plan (the “First Plan”) related to her May 2019 filing. The First Plan provided that, beginning on June 20, 2019, she would pay the Bank \$1,000 per month. She would continue those payments for 60 months, and, on or before September 20, 2019, she would make a lump sum payment of \$380,000 to the Bank on the mortgage debt.

The company servicing the mortgage for the Bank objected to the First Plan, asserting that the scheduled payments would

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not cover the actual mortgage arrearages.⁸ In response, in September 2019, Soussis proposed an amended plan (the “Second Plan”): she would pay the Bank \$1,000 per month for each of the three months from June 20, 2019, to September 20, 2019; she would then pay \$2,900 per month for 56 months; and then, on or before November 29, 2019, she would make a lump sum payment to the Bank of \$340,000, covering the remaining arrearages.

A confirmation hearing on the Second Plan was scheduled for August 8, 2019. It did not occur: Soussis postponed that hearing date. She also postponed the other hearing dates set by the court for late 2019 (September 26, December 5, December 19), and for early 2020 (January 9, January *426 23, April 16, and June 11). And then, on June 29, 2020—over one year after her initial filing in May 2019, with the Second Plan still yet to be heard by the court—Soussis moved to dismiss her Chapter 13 petition altogether.⁹ The Bankruptcy Court granted her motion on June 30, 2020.¹⁰

B. Standing Trustee Macco's fee-related proceedings

Michael Macco, a standing trustee in the Eastern District of New York and one of the two appellees here, was appointed to handle Soussis's 2019 bankruptcy case. William K. Harrington, the U.S. Trustee for Region 2 (New York, Connecticut, and Vermont), was responsible for supervising Macco's performance of his duties. *See* 28 U.S.C. § 586(b). U.S. Trustee Harrington appeared in the bankruptcy proceedings and the District Court appeal, and he is also an appellee here. In our discussion below, we refer to Standing Trustee Macco and U.S. Trustee Harrington collectively as the “Trustees.”

Section 1326(a)(1) of title 11 required Soussis to “commence making payments ... in the amount ... proposed by the plan to the trustee” within 30 days after she filed for bankruptcy. Macco, as the standing trustee in her case, would then “retain[]” those payments “until confirmation or denial of confirmation.” 11 U.S.C. § 1326(a)(2). If a plan had been confirmed, Macco would have then “distribute[d]” those payments to creditors “in accordance with the plan as soon as [was] practicable.” *Id.* But since no plan was confirmed, he distributed no payments to creditors and was instead obligated to “return any such payments ... to [Soussis].” *Id.*

After the June 30 dismissal, Macco prepared and filed his final report of receipts and disbursements. In his report, Macco averred that over the approximately 13 months after filing the Second Plan, Soussis made \$362,100 in pre-confirmation payments. Macco further reported that, after the case was dismissed, he took \$20,592 for his percentage fee, representing approximately 5.7% of the \$362,100 paid in by Soussis. He returned the remaining \$341,508 to her.

[3] Soussis objected to his retention of the percentage fee and sought an order requiring Macco to disgorge the \$20,592 that he had kept.¹¹ She contended that Section 1326(a)(2) of title 11 requires a Chapter 13 standing trustee to collect and to hold his percentage fee, but only provisionally, until a plan is confirmed. Absent plan confirmation, she asserted, the Chapter 13 standing trustee must refund the *427 fee to the debtor upon dismissal of the case, just as he must return to the debtor the amounts collected and held on behalf of creditors.¹² The Trustees took the opposite position, arguing that because 28 U.S.C. § 586(e)(2) directs the standing trustee to “collect” the fee out of all “payments made under the plan,” the standing trustee is entitled to keep the fee, whether or not the plan is confirmed. They urged that Section 1326(a)(2) exempts the percentage fee from the obligation to return the collected amount to the debtor.

The Bankruptcy Court denied Soussis's motion, adopting the Trustees' reasoning: it concluded that, by directing the standing trustee to “collect” the percentage fee, Section 586(e)(2) means that “[t]he percentage fee is the Trustee's to keep, regardless of whether the debtor's plan is confirmed.” *In re Soussis*, 624 B.R. 559, 564 (Bankr. E.D.N.Y. 2020). On appeal to the District Court, the district judge acknowledged that “some courts have interpreted the relevant statutes to reach a contrary conclusion,” but in the end, it adopted the Bankruptcy Court's analysis and affirmed its ruling. *Soussis v. Macco*, No. 20-cv-05673, 2022 WL 203751, at *2 (E.D.N.Y. Jan. 24, 2022).

Soussis timely sought this Court's review.

DISCUSSION

[4] [5] [6] [7] [8] Because this case “turns on questions of statutory interpretation,” we review the District Court's

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ruling *de novo*. *In re Treco*, 240 F.3d 148, 155 (2d Cir. 2001). We start, as always, by examining the text of the relevant statutory provisions to discern their plain meaning. Plain meaning is informed by, but does not depend solely on, dictionary definitions. See *United States v. Rowland*, 826 F.3d 100, 108 (2d Cir. 2016). Rather, to ascertain a text's plain meaning, we draw on “the specific context in which that language is used, and the broader context of the statute as a whole.” *Id.* (internal quotation marks omitted). If the statutory text is unclear, we may also “consult the legislative history to discern ‘the legislative purpose as revealed by the history of the statute.’ ” *United States v. DiCristina*, 726 F.3d 92, 96–97 (2d Cir. 2013) (quoting *Concrete Pipe & Prods. of Cal., Inc. v. Constr. Laborers Pension Tr. for S. Cal.*, 508 U.S. 602, 627, 113 S.Ct. 2264, 124 L.Ed.2d 539 (1993)).

[9] Here, we conclude that the text, legislative history, and statutory purpose are aligned: each supports the view that standing trustees may not keep a percentage of the debtor's pre-confirmation payments as a fee if no plan is confirmed. We *428 therefore join the Seventh, Ninth, and Tenth Circuits in holding that, under such circumstances, the standing trustee must return any percentage fee that he has collected. See *Marshall v. Johnson*, 100 F.4th 914 (7th Cir. 2024); *Matter of Evans*, 69 F.4th 1101 (9th Cir. 2023), *cert. denied sub nom. McCallister v. Evans*, — U.S. —, 144 S. Ct. 1004, 218 L.Ed.2d 22 (2024); *In re Doll*, 57 F.4th 1129 (10th Cir. 2023), *cert. denied sub nom. Goodman v. Doll*, — U.S. —, 144 S. Ct. 1001, 218 L.Ed.2d 20 (2024).

I. Section 1326 and Section 586 are properly interpreted together and require the standing trustee to return the percentage fee to the debtor if no plan is confirmed.

The parties agree that two statutory provisions bearing on Chapter 13 bankruptcy proceedings are central to resolving this dispute: Section 586 of title 28¹³ and Section 1326 of title 11.¹⁴ As we have explained, Section 586 directs the standing trustee to “collect” his percentage fee “from all payments received by [the trustee] under [Chapter 13] plans” that the trustee administers. Section 1326(a)(1) requires Chapter 13 debtors to make pre-confirmation payments to the trustee in an amount “proposed by the [debtor's] plan[.]” The trustee must then “retain[]” those payments pending

“confirmation or denial of confirmation” and “return” the payments if no plan is confirmed. 11 U.S.C. § 1326(a)(2).

We thus ask: Is the percentage fee established by Section 586 a part of the “payments ... proposed by the plan” that, under Section 1326(a)(2), the trustee must return to the debtor when a plan is not confirmed? Or rather, is it not so that the trustee may deduct and keep his percentage fee before returning the payments? Reading Section 586 and Section 1326 in tandem, we hold that the trustee's percentage fee is included in the payments proposed and made that the standing trustee must return to the debtor. He may not deduct and keep it.

A. The word “payments” in Section 1326(a) covers all of the debtor's obligations, including the trustee's fee.

We start by looking to the plain text of these statutes to determine whether the *429 phrase “payments ... proposed by the plan,” 11 U.S.C. § 1326(a)(1), includes the standing trustee's percentage fee. We conclude that it does. Under Section 586(e)(2), the standing trustee “shall collect [his] percentage fee from all payments received by [the trustee]” under Chapter 13 plans that the trustee administers. 28 U.S.C. § 586(e)(2). That is, the percentage fee is taken from—and thus is part of—the “payments ... proposed by the plan[.]” 11 U.S.C. § 1326(a)(1). Read together with Section 586(e)(2), then, Section 1326(a)(2) requires that the percentage be returned to the debtor when a plan is not confirmed.

[10] The text of Section 1326(b) confirms this interpretation. It provides that the percentage fee “shall be paid” “[b]efore or at the time of each payment to creditors under the plan[.]” *Id.* § 1326(b). The trustee distributes payments to creditors under the plan only after the plan has been confirmed (otherwise, the payments must be “return[ed]” to the debtor).¹⁵ *Id.* § 1326(a)(2). Thus, “[b]ecause the trustee will never pay creditors if no plan is confirmed, and [Section] 1326(b) provides for payment of trustee fees before or [at] the time the trustee pays creditors, it follows that, if confirmation never happens, [Section] 1326(b) does not contemplate payment of the trustee's percentage fee.” *In re Acevedo*, 497 B.R. 112, 121 (Bankr. D.N.M. 2013); see *In re Doll*, 57 F.4th at 1145 (same).¹⁶

A review of relevant Chapter 13 procedures confirms that, in practice, the payments a debtor proposes in her plan

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include the trustee's percentage fee, as well as the outstanding arrearages. The standard form that a debtor must use to submit her proposed Chapter 13 plan asks her to estimate the percentage of her payments that will cover the percentage fee. See Official Form 113 at 5 ("Trustee's fees are governed by statute and may change during the course of the case but are estimated to be ___% of plan payments; and during the plan term, they are estimated to total \$___.")¹⁷ An exhibit to the form instructs the debtor to calculate the total payments she will make to the trustee by adding up all of the line-items listed *430 in the plan, including the trustee's percentage fee. *Id.* at 9. To repay the total amount, the debtor's plan "ordinarily proposes monthly lump sum payments to the trustee" over a three- or five- year period. *In re Acevedo*, 497 B.R. at 119; see E.D.N.Y. Chapter 13 Model Plan § 2.1 ("Debtor(s) shall pay to the Trustee for a period of months as follows:"). Debtors need not separately pay the percentage fee, because the trustee is expected to collect the percentage fee from the payments disbursed under the plan.¹⁸ *In re Dickens*, 513 B.R. 906, 913 (Bankr. E.D. Ark. 2014) (describing testimony from Trustee's Office case operations administrator that the percentage fee is "part and parcel of the monthly payments made to the Trustee" and is "included in the monthly lump sum payment written down in the blank space provided for in the model plan used by debtors").

Moreover, when the debtor's proposed plan does not provide enough funds to cover all of the debtor's obligations including the percentage fee, the standing trustee or a creditor may object to its confirmation. *Id.* In Soussis's case, for instance, a creditor objected to the First Plan on grounds that the proposed payments were "not sufficient to satisfy the actual arrears and to pay the Chapter 13 trustee required commissions and any other distributions or payments that may be required in the case." Objection to Confirmation of Plan ¶4, *In re Soussis*, No. 8-19-73686-reg (Bankr. E.D.N.Y.) (ECF No. 14). Soussis then filed the Second Plan, increasing the proposed monthly payments.

In sum, in the Chapter 13 context, the term "payments ... proposed by the plan," 11 U.S.C. § 1326(a)(1), means the debtor's entire schedule of monthly lump sum payments. This aggregation includes an unspecified amount for the percentage fee. Accordingly, the percentage fee—like the

amounts allocated to any other line-items in the plan—must be returned to the debtor if no plan is confirmed.

B. Section 1326(a)(2) does not permit the standing trustee to deduct his percentage fee before he returns payments to the debtor.

To determine whether the percentage fee is part of the payments that must be returned under Section 1326(a)(2), we look not only to the amounts that the subsection directs the standing trustee to return when a plan is not confirmed ("payments ... proposed by the plan"), but also to the exceptions to its return rule.

Congress created two express exceptions in Section 1326(a)(2), as follows: "[i]f a plan is not confirmed, the trustee shall return any [pre-confirmation] payments *not previously paid and not yet due and owing to creditors pursuant to paragraph (3) to the debtor, after deducting any unpaid claim allowed under [S]ection 503(b).*" 11 U.S.C. § 1326(a)(2) (emphases added). Thus, the trustee may exclude from the payments returned: (1) amounts "previously paid" or "due and owing" to creditors under Section 1326(a)(3); and (2) amounts for administrative expenses "allowed under [S]ection 503(b)." *Id.*

As explained below, neither of these exceptions includes the percentage fee. Since Congress has expressly enumerated exceptions that do not include the percentage fee, we can reasonably infer absent express language to the contrary that no percentage fee exception exists.

*431 1. *The percentage fee does not fit within Section 1326(a)(2)'s listed exceptions to the return obligation.*

Amounts "previously paid" or "due and owing" to creditors. First, the percentage fee is not an amount "previously paid and ... due and owing to creditors pursuant to paragraph (3)." *Id.* The referenced "paragraph (3)"—11 U.S.C. § 1326(a)(3), that is—allows the Bankruptcy Court to "modify, increase, or reduce" the pre-confirmation payments obligations "pending confirmation of a plan."¹⁹ Here, the Bankruptcy Court did not enter any order altering Soussis's proposed pre-confirmation payment obligations.

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In addition, this exception applies to only amounts “previously paid” or “due and owing” to “creditors.” *Id.* § 1326(a)(2) (emphasis added). As we have explained, before a plan is confirmed, the trustee does not distribute any payments under the plan to creditors. *Id.* So payments “previously paid” or “due and owing” must refer to two types of payments that debtors are obligated to make “directly to” creditors in the pre-confirmation period: payments on current personal property leases, *id.* § 1326(a)(1)(B), and “adequate protection” payments to certain secured creditors, *id.* § 1326(a)(1)(C). Indeed, Congress added this requirement that debtors make direct-to-creditor payments before confirmation in a 2005 amendment to Section 1326(a), which also inserted the phrase “not previously paid and not yet due and owing to creditors” into Section 1326(a)(2). See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 309(c)(2), 119 Stat. 23, 83. Soussis herself was not required to make and did not make any such pre-confirmation lease or adequate protection payments.²⁰ Moreover, the trustee’s fee is not paid or owed to creditors: it goes directly to the trustee. Therefore, the stated exception for amounts “previously paid” or “due and owing” to creditors does not include the trustee’s percentage fee.

The Trustees insist that the percentage fee is an amount “previously paid,” reasoning that the fee is collected by the trustee as soon as each pre-confirmation payment is received. Their interpretation ignores the last portion of the statutory clause. The full clause states that the amounts must be previously paid “to creditors pursuant to paragraph (3)[.]” 11 U.S.C. § 1326(a)(2) (emphasis added). As the Tenth Circuit observed, the Trustees’ reading would effectively split the clause into two parts, so that it directs the trustee to return pre-confirmation payments that are “[1] not previously paid and [2] not yet due and owing to creditors pursuant to paragraph (3).” *In re Doll*, 57 F.4th at 1141 n.8.

[11] [12] [13] This is not a viable construction. We see no reason to think that Congress intended to cleave the text in this awkward way. The Trustees do not explain why the amounts “due and owing”—and not the amounts “previously paid”—would go “to creditors pursuant to paragraph (3)[.]” 11 U.S.C. § 1326(a)(2). The more natural reading is that the phrase “previously paid and ... due and owing” merely refers to different moments in the payment process: the “payments ... to creditors” *432 might be already paid, or they might

have been collected by the trustee, but not yet paid (and thus remain “due and owing”). *Id.* We therefore conclude that Section 1326(a)(2) excepts only those amounts “previously paid ... to creditors pursuant to paragraph (3),” not all amounts “previously paid.” *Id.* (emphasis added).²¹

The legislative history of this section further undermines the Trustees’ view and leaves little doubt that Congress intended to refer only to those “previously paid” amounts that went “to creditors pursuant to paragraph (3)[.]” *Id.* In an early draft of the bill that became this law, the relevant subsection directed the trustee to return any “payments *not previously paid to creditors* pursuant to paragraph (3)[.]” S. 625, 106th Cong. § 309(c)(2) (1999) (emphasis added). The phrase “not yet due and owing” was inserted by a 1999 amendment to the bill. S. Amdt. 1723, 145 Cong. Rec. S11151 (daily edition Sept. 21, 1999); see Robin Jeweler, Cong. Rsch. Serv. RS20433, S. 625, The Bankruptcy Reform Act in the Senate: Selected Amendments 6 (Jan. 28, 2000) (explaining that, with the amendment, “[i]f a debtor makes payments into a [C]hapter 13 plan that is not confirmed, the trustee must return to the debtor payments *not previously paid to creditors ‘and not yet due and owing’*” (emphasis added)). This history persuades us all the more that Congress intended the phrase “previously paid” to be modified by the phrase “to creditors pursuant to paragraph (3).” And, as earlier explained, the percentage fee collected here meets none of the requirements set forth in the clause: it has not been modified by court order under paragraph (3), and it is not paid or owed to creditors.²²

Administrative expenses. Section 1326(a)(2) also allows the trustee to “deduct[*433] any unpaid claim for [administrative expenses] allowed under [S]ection 503(b)” from the payments he returns to the debtor. 11 U.S.C. §§ 1326(a)(2), 503(b). However, the percentage fee is not, the parties agree, the type of “administrative expense” that is covered by Section 503(b). Section 503(b) of title 11 covers the fee for the debtor’s attorney, *id.* §§ 503(b)(2), 330(a)(4) (B), and for the ad hoc trustee, *id.* §§ 503(b)(2), 330(a)(1), 326(b), 1302, among other fees and expenses. But it does not cover the standing trustee’s fee. *Id.* § 326(b) (providing that the Bankruptcy Court “may not allow compensation for services or reimbursement of expenses of ... a standing trustee” under Section 330, and by extension under Section 503(b)).

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2. Congress's choice to include express exceptions to the return rule suggests that other exceptions—such as for the trustee's percentage fee—should not be inferred.

As described, Congress expressly identified two exceptions to the general rule that pre-confirmation payments must be returned to the debtor if no plan is confirmed. The Supreme Court has explained that, “[w]here Congress explicitly enumerates certain exceptions to a general [rule], additional exceptions are not to be implied, in the absence of evidence of a contrary legislative intent.” *Andrus v. Glover Constr. Co.*, 446 U.S. 608, 616–17, 100 S.Ct. 1905, 64 L.Ed.2d 548 (1980); see *Krauss v. Oxford Health Plans, Inc.*, 517 F.3d 614, 625 (2d Cir. 2008) (referring to “canon that expressing one item of a commonly associated group or series excludes another left unmentioned”). That Congress did not include the percentage fee among Section 1326(a)(2)’s exceptions, then, creates a strong basis for concluding that no such exception can be inferred and that the percentage fee, too, must be returned.

[14] We find additional evidence for this view in Congress's directive that administrative costs be “deduct[ed]” from the pre-confirmation payments that are to be returned to debtors when a case is dismissed. *434 11 U.S.C. § 1326(a)(2). The use of “deduct” in Section 1326(a)(2) suggests that those administrative costs would—but for the deduction—be included in the “payments ... proposed by the plan” that must be “return[ed]” to the debtor. *Id.* § 1326(a)(1)–(a)(2). And if those “payments” include administrative expenses, we cannot see how they could exclude the standing trustee's percentage fee. After all, the statute directs that the administrative expenses and the standing trustee's fee be paid at the same time: “[b]efore or at the time of each payment to creditors under the plan.” *Id.* § 1326(b). And administrative expenses and the percentage fee often go hand-in-hand in bankruptcy proceedings. See Official Form 113 at 5 (listing trustee's fee alongside “fees and priority claims,” including Section 503(b) administrative expenses); Chapter 13 Practice & Procedure § 6:7 (explaining that “[a]lthough the standing Chapter 13 trustee's fees are not technically an administrative expense claim because they are not paid under the authority of Code § 503(b), they are often loosely referred to as such”). Therefore, the “payments” that must be “retained” before confirmation include both Section 503(b) administrative expenses and

quasi-administrative expenses like the percentage fee. 11 U.S.C. § 1326(a)(2). When those payments are returned to debtors, Congress has expressly allowed the deduction of the Section 503(b) administrative expenses, but not the percentage fee. *Id.*

The Bankruptcy Court's interpretation of Section 1326(a)(2) would turn the express allowance of an administrative-expenses deduction into mere surplusage. In that court's view, the only payments that must be returned under Section 1326(a)(2) are “funds earmarked for creditors.” *In re Soussis*, 624 B.R. at 573. But if so, then those “payments” would not include Section 503(b) administrative expenses either, since administrative expenses are generally not “earmarked for creditors.”²³ The clause providing for administrative expenses to be deducted would therefore be largely superfluous, a result we hesitate to accept. See *Sec. & Exch. Comm'n v. Govil*, 86 F.4th 89, 100–01 (2d Cir. 2023).

For all these reasons, we think that the payments in “the amount ... proposed by the plan” in Section 1326(a)(2) refers to the entire sum of the pre-confirmation payment, including the amounts intended to cover the trustee's percentage fees. Under Section 1326(a)(2), the trustee must “retain[]” those payments and, if no plan is confirmed, “return [them] ... to the debtor,” deducting only those amounts specifically exempted by the statute. *Id.* Because the statute does not authorize the trustee to deduct an amount for the percentage fee, that amount too must be returned to the debtor if no plan is confirmed.

C. If no plan is confirmed, Section 586(e) does not authorize the standing trustee to keep the percentage fee from the amounts he “collects.”

[15] The Trustees urge that, notwithstanding the text of Section 1326, the trustee may deduct the percentage fee from the debtor's pre-confirmation payments by virtue of 28 U.S.C. § 586. Section 586(e)(2) directs that the standing trustee “shall collect [the] percentage fee from all payments *435 received by [the trustee] under plans in [Chapter 11 (Subchapter V), Chapter 12, and Chapter 13 cases] for which [he] serves as standing trustee.” According to the Trustees, Section 586(e)(2) authorizes them to collect and keep the percentage fee, rather than to collect and hold it subject to some future event. Considering the statutory scheme as a whole, we conclude that the verb “collect,” as used in Section

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586(e)(2), is ambiguous. Its use in Section 586(e)(2) does not alter our reading of the plain language of Section 1326(a)(2), nor our conclusion that the fee must be returned absent plan confirmation.

The dictionary definition of “collect,” in the context of financial transactions, is “to gather [assets or funds],” or “to obtain payment.” See Collect, Black’s Law Dictionary 328 (4th ed. 1968) (“To gather together; to bring scattered things (assets, accounts, articles of property) into one mass or fund; to assemble. To collect a debt or claim is to obtain payment or liquidation of it[.]”); Collect, The American Heritage Dictionary 261 (William Morris, ed., 1976) (“To bring together in a group; gather; assemble To call for and obtain payment of: collect taxes To take in payments or donations.”); Collect, West’s Legal Thesaurus/Dictionary 148 (West Pub. Co. 1986) (“To bring scattered things into one mass (the assets were collected) To obtain payment (the creditor came to collect on the debt).”); Collect, Webster’s Third New International Dictionary (Philip Babcock Gove, ed., 1986) (“[T]o receive, gather, or exact from a number of persons or other sources”). In *Vincent v. The Money Store*, we interpreted “collect” in the context of the Fair Debt Collection Practices Act and concluded based on similar dictionary definitions that it means “‘to gather (contributions of money, or money due, as taxes, etc.) from a number of people.’ ” 736 F.3d 88, 100 (2d Cir. 2013) (quoting 1 The Compact Edition of the Oxford English Dictionary 465 (1971)) (alteration adopted).

Applying these definitions here, we understand to “collect” a percentage fee under Section 586(e)(2) as meaning to “gather” or “receive” that fee. Without more context, however, it is unclear what rights or obligations, if any, a reasonable reader would understand the word “collect” to imply once the collected item has been gathered or received. See *Pettus v. Morgenthau*, 554 F.3d 293, 297 (2d Cir. 2009). One plausible reading of “collect,” as advanced by the Trustees, is that the collector, once having gathered or received, would be entitled to *keep* the fee. An equally plausible reading, however, is that the collector, having gathered or received, would then *hold* the designated sum, pending any number of further developments.

Section 586 is thus amenable to at least two plausible readings: to gather and keep, or to gather and hold depending on a future event. Both require us to “read an absent

word”—“keep” or “hold”—“into the statute.” *Lamie v. U.S. Trustee*, 540 U.S. 526, 538, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004); see also *Matter of Evans*, 69 F.4th at 1106. We decline to do so. Instead, we conclude that the word collect as used in Section 586 is ambiguous.²⁴

***436** This ambiguity tends to confirm the proposition that, in enacting Section 586(e)(2), Congress likely did not intend to resolve the question posed in this case: how standing trustees should handle pre-confirmation payments if the plan is not confirmed. In 1978, when Congress enacted Section 586(e)(2)’s predecessor, Chapter 13 did not require debtors to make any pre-confirmation payments at all—Congress had not passed the law that would become Section 1326(a).²⁵ So it seems to us unlikely that Congress intended the general directive to the trustee in Section 586—that he “shall collect [the] percentage fee”—to preemptively reject any future procedures adopted for pre-confirmation payments.

Congress later amended Section 586(e)(2), expanding it first in 1986 to apply to Chapter 12 standing trustees, and again in 2019 to cover Chapter 11 (Subchapter V) standing trustees as well.²⁶ Each of those chapters contains specific provisions setting forth procedures for handling the debtor’s pre- and post-confirmation payments. See 11 U.S.C. §§ 1194; 1226, 1326. Those specific provisions, not Section 586, serve as the better guide. See *Cnty. Health Care Ass’n of New York v. Shah*, 770 F.3d 129, 157 (2d Cir. 2014) (“It is a basic principle of statutory construction that a specific statute controls over a ***437** general provision.” (alteration adopted; internal quotation marks omitted)).

We therefore conclude that Section 586(e)(2) was intended to set forth, in general terms, the source of the standing trustee’s compensation. It simply does not direct when the percentage fee should be collected, what should happen after the fee is collected, or whether the fee must be returned if the plan is not confirmed. And it does not alter our interpretation of the text of Section 1326(a)(2), which in our view requires that the percentage fee be returned to the debtor.

* * *

[16] Accordingly, reading Section 586 and Section 1326 together, we hold that the statutes require the following procedures: In the pre-confirmation period, the debtor must

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propose a plan and begin making payments under the plan, including in those payments an amount sufficient to cover the standing trustee's percentage fee. 11 U.S.C. § 1326(a)(1). The standing trustee may “collect” the percentage fee, 28 U.S.C. § 582(e)(2), along with the rest of the pre-confirmation payments, but he must “retain[]” (i.e., hold) both the percentage fee and creditor payments until plan “confirmation or denial of confirmation[.]” 11 U.S.C. § 1326(a)(2). If the plan is confirmed, the standing trustee will distribute the payments “as soon as is practicable” to creditors in accordance with the plan. *Id.* He will be paid the percentage fee “before or at the time” of those disbursements. *Id.* § 1326(b). If the plan is not confirmed, however, the standing trustee must “return” all pre-confirmation payments to the debtor, excluding only those amounts specifically exempted by the statute (i.e., amounts “previously paid” or “due and owing” to creditors, and Section 503(b) administrative expenses). *Id.* § 1326(a)(2). Because his percentage fee is not specifically exempted, he must also return the portion of the payments that might have covered his fee if the plan had been confirmed. He may not keep the fee or deposit it into the U.S. Trustee System Fund.

II. A textual comparison to parallel provisions for Chapter 12 and Chapter 11 (Subchapter V) bankruptcies confirms our interpretation.

Further support for our conclusion is found when we consider how Congress has addressed the analogous fee question for standing trustees in bankruptcies under Chapter 12 and Chapter 11 (Subchapter V) (“Chapter 11(V)”).

A. The parallel provisions in Chapter 12 and Chapter 11(V)

Chapter 12 (created in 1986) and Chapter 11(V) (created in 2019) set out bankruptcy procedures designed for family farmers and small business owners, respectively. Both chapters were added to the bankruptcy code after Chapter 13 was enacted, and they both borrow from Chapter 13. Compare 11 U.S.C. §§ 1321–30 (procedures for Chapter 13 plans) with *id.* §§ 1221–32 (same for Chapter 12); and *id.* §§ 1189–95 (same for Chapter 11(V)). Under all three chapters, a “standing trustee” in a region supervised by a U.S. Trustee administers most cases and “collect[s]” a percentage fee from “all payments received by [the trustee] under plans” for which he serves as trustee. 28 U.S.C. § 586(e)(2). Each chapter

also contemplates pre-confirmation payments to the standing trustee, *see* 11 U.S.C. §§ 1326, 1226, 1194—although under Chapter 13 those payments are mandatory (unless the court orders otherwise), *id.* § 1326(a), while under Chapter 12 and Chapter 11(V) pre-confirmation payments are not required, *id.* §§ 1226, 1194. Finally, each chapter includes a provision directing the *438 trustee (1) to “retain[]” pre-confirmation payments “until confirmation or denial of confirmation” of a plan; (2) “if a plan is confirmed,” to “distribute any such payment in accordance with the plan”; and (3) “[i]f a plan is not confirmed,” to “return any such payments” to the debtor. *Id.* §§ 1326(a)(2), 1226(a), 1194(a).

Chapter 12's and Chapter 11(V)'s pre-confirmation procedures differ from Chapter 13's in a critical way, however: Chapter 12 and 11(V) *expressly authorize* the standing trustee to deduct his percentage fee before returning payments to the debtor if a plan is not confirmed. The Chapter 12 provision governing pre-confirmation payments states:

Payments and funds received by the trustee shall be retained by the trustee until confirmation or denial of confirmation of a plan. If a plan is confirmed, the trustee shall distribute any such payment in accordance with the plan. If a plan is not confirmed, the trustee shall return any such payments to the debtor, after deducting—

(1) any unpaid claim allowed under section 503(b) of this title; and

(2) if a standing trustee is serving in the case, the percentage fee fixed for such standing trustee.

11 U.S.C. § 1226(a) (emphasis added). The parallel provision in Chapter 11(V) reads:

Payments and funds received by the trustee shall be retained by the trustee until confirmation or denial of confirmation of a plan. If a plan is confirmed, the trustee shall distribute any such payment in accordance with the plan. If a plan is not confirmed, the trustee shall return any such payments to the debtor after deducting—

(1) any unpaid claim allowed under section 503(b) of this title;

(2) any payment made for the purpose of providing adequate protection of an interest in property due to the holder of a secured claim; and

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(3) any fee owing to the trustee.

11 U.S.C. § 1194(a) (emphasis added).

That Congress included an explicit command to deduct the trustee's fee in Sections 1226(a) and 1194(a) and did not repeat that command in the parallel provision in Section 1326(a)(2) suggests that Congress likely intended something different in Chapter 13 proceedings.

B. The legislative histories of Sections 1326, 1226, and 1194 are consistent with this reading.

[17] The Trustees argue that the relevant legislative history undermines any attempt to draw meaning from the comparison of Sections 1226(a) and Section 1194(a) with Section 1326(a)(2) that we have just set out. They urge that, because the three provisions were enacted at different times and for different purposes, any differences in their texts do not bear on Congress's intentions.

True, “[t]he Supreme Court has cautioned against finding ‘negative implications raised by disparate provisions’ when ‘the two relevant provisions were not considered or enacted together.’” *Pfizer, Inc v. United States Dep't of Health & Hum. Servs.*, 42 F.4th 67, 78 (2d Cir. 2022) (quoting *Gomez-Perez v. Potter*, 553 U.S. 474, 486, 128 S.Ct. 1931, 170 L.Ed.2d 887 (2008)) (alteration adopted). We therefore scrutinize this legislative history closely before drawing inferences from the course of legislative events. But having done so, we find that the legislative history confirms that Congress was aware of and intended the differences among the three provisions. Those differences lend further support to our reading of Section 586 and Section 1326.

*439 The pertinent legislative history is as follows.

In 1984, Congress enacted Chapter 13's Section 1326(a)(2).²⁷ It originally read in relevant part: “If a plan is not confirmed, the trustee shall return any [pre-confirmation] payments to the debtor, after deducting any unpaid claim allowed under [S]ection 503(b) of this title.”²⁸

Two years later, in 1986, Congress added Chapter 12 to the bankruptcy code.²⁹ Chapter 12 was “modeled on [C]hapter 13,” and “many of [its] provisions are identical” to those

found in Chapter 13. *Hall v. United States*, 566 U.S. 506, 516, 132 S.Ct. 1882, 182 L.Ed.2d 840 (2012) (quoting 8 Collier ¶ 1200.01[5]); H.R. Conf. Rep. No. 99-958, at 48 (1986) (“This new chapter is closely modeled after existing Chapter 13.”). But Congress did “alter[] those [Chapter 13] provisions that are inappropriate for family farmers,” such as “the requirement that plan payments start within 30 days of the plan confirmation[.]” *Id.* Most critically here, Chapter 12's new Section 1226(a) used verbatim much of the language of the then-effective Section 1326(a)(2). The main exception was that, in Chapter 12 cases, Congress allowed the standing trustee to “deduct ... the percentage fee” before returning pre-confirmation payments to the debtor.³⁰ Chapter 12's Sections 1226(b) and (c), on the other hand, were identical to the then-effective Sections 1326(b) and (c).³¹ As part of the 1986 bill, Congress also amended Section 1326(b) to include a citation to Section 586(e)(2).³² It nevertheless left Section 1326(a) untouched.

*440 Over the next two decades, Congress made several amendments to the text of Section 1326(a)(2). In 1994, it clarified that if a plan was confirmed, payments should be distributed “as soon as practicable.”³³ In 2005, as discussed above, it added the phrase “not previously paid and not yet due and owing to creditors pursuant to paragraph (3),” effectively adding a second exception to the rule that pre-confirmation payments must be returned to the debtor.³⁴

Finally, in 2019, Congress created Chapter 11(V) for small business owners, also borrowing in part from the existing Chapters 12 and 13.³⁵ The Chapter 11(V) provision governing pre-confirmation payments, like that in Chapter 12, copies much of the text of Chapter 13 but explicitly permits the trustee to deduct his percentage fee before returning payments to the debtor. See 11 U.S.C. § 1194(a). Congress also allowed the deduction of pre-confirmation adequate protection payments “due” to certain secured creditors, *id.* § 1194(a)(2), similar to the provision in Chapter 13 exempting “adequate protection” payments that were “already paid” or “due and owing” to creditors, *id.* §§ 1326(a)(1)(C), (a)(2).

Thus, the legislative history reveals that while Sections 1326, 1226, and 1194 were each enacted in different years, they are closely related. Congress modeled Section 1226(a) and Section 1194(a) on the pre-existing Section 1326(a)(2),

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and the three provisions are nearly identical. If Congress believed that the text of [Section 1326\(a\)\(2\)](#) already allowed the deduction of the standing trustee's percentage fee, it could have copied that exact language into [Section 1226\(a\)](#) and [Section 1194\(a\)](#). Instead, it chose to add a provision to each section explicitly allowing for the deduction of the trustee's fee. Under the Trustees' reading, those additions would have been entirely unnecessary.

Moreover, if Congress wished to allow standing trustees to deduct the percentage fee before returning Chapter 13 pre-confirmation payments, it has missed many opportunities to amend [Section 1326\(a\)\(2\)](#) to make that intent clear. In 1986, for instance, Congress simultaneously (1) copied much of the text of [Section 1326\(a\)\(2\)](#) into [Section 1226\(a\)](#), adding the express provision allowing the deduction of the percentage fee; (2) amended [Section 1326\(b\)](#); and (3) left [Section 1326\(a\)\(2\)](#) unaltered. This inaction, too, tends to confirm that Congress intended the differences between [Section 1326\(a\)\(2\)](#) and [Section 1226\(a\)](#) to carry meaning. And, since that 1986 amendment, Congress has repeatedly updated [Section 1326\(a\)\(2\)](#) but has never added an explicit provision allowing the standing trustee to deduct his percentage fee from the payments that must be returned to debtors when a Chapter 13 plan is not confirmed.

Under these circumstances, we conclude that Congress's choice to omit that language from [Section 1326\(a\)\(2\)](#) was intentional, and that the standing trustee must return all sums collected. No percentage fee may be retained.³⁶

***441 III. Barring the trustee from retaining a fee when a plan is not confirmed is consistent with the policy goals underlying Chapter 13.**

Finally, the "legislative purpose as revealed by the history" of Chapter 13 also supports our conclusions regarding relevant statutory provisions. *Concrete Pipe & Prods. of Cal.*, 508 U.S. at 627, 113 S.Ct. 2264.

From all we can see, pre-confirmation payments in Chapter 13 cases were never intended to serve as a source of added compensation for the standing trustees. Instead, the early payments were designed to "provide a good test of whether the debtor w[ould] be able to carry out the plan." S. Rep. No. 98-65, at 63 (1983). While the bankruptcy code did not require pre-confirmation payments before 1984,

some districts had established local rules requiring them or something similar. *Id.* Thus, in the lead-up to Congress's enactment of the 1984 bankruptcy reform bill, Chapter 13 trustees reported to Congress that:

[W]here payments commence near the time the plan is filed[,] there is a much greater incidence of compliance with the plan If payments are delayed until confirmation, the debtor may become accustomed to a level of expenditures which is difficult to reduce Where commencement of payment is delayed until confirmation of the plan, debtors frequently default, or must bear the time and expense of a separate proceeding to modify the plan.

Id.

With the 1984 reform, Congress set the months between the plan's filing and its confirmation as a test period, in which the debtor had to prove that she could make the required payments. Critically, however, and consistent with the notion of a test period, Congress made the payments reversible, directing the trustee to return the payments to the debtor if the plan proved unworkable. 11 U.S.C. § 1362(a)(2). In doing so, Congress struck a careful balance between two competing goals: its desire to ensure that debtors filing for Chapter 13 bankruptcy had a realistic chance of completing payments and securing a discharge of their debts, on the one hand, and the need to avoid imposing large costs on those debtors who proved unable to make payments, on the other.

The Trustees cite two main reasons for their view that requiring the standing trustee to return his percentage fee if no plan is confirmed is contrary to Congress's policy goals. First, they say that the standing trustee should be compensated by the debtor for the work that he must perform in the pre-confirmation period, and if the fee is returnable, he is simply left unpaid. Second, they suggest that allowing the debtor to avoid paying the percentage fee will encourage bad faith

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Chapter 13 filings by people seeking only to delay foreclosure or other efforts at collection.

[18] As to the first point—the need to compensate the standing trustee for the work he performs—the Trustees’ argument is at odds with the compensation structure that [Section 586](#) creates. The percentage fee system does not compensate standing trustees based on the time devoted to or any other aspect of the quality or quantity of work done on a *442 particular Chapter 13 case. Rather, the amount of the percentage fee that the trustee is authorized to “collect” turns simply on the amount of a debtor’s actual payments to creditors. Thus, the trustee will receive less from a debtor making low monthly payments than from one making high monthly payments, whatever the distribution of the related workloads.

[19] It is in the nature of this system that certain cases—those in which a debtor completes all payments and the payment amounts are large—will provide more support to the trustee and the trustee system than will other cases. And, in turn, the cost of administering the trustee system is also subsidized by bankruptcy cases under Chapters 7 and Chapter 11, which tend to involve larger estates than does Chapter 13. *See Siegel*, 596 U.S. at 469, 142 S.Ct. 1770 (explaining that the “bulk of” user fees paid into the U.S. Trustee System Fund, in fact, are “paid by debtors who file cases under Chapter 11 of the Bankruptcy Code”). But Congress did not create a fee-for-service system for standing trustees, as it did for ad hoc trustees. *See* 11 U.S.C. § 330(a)(1). Instead, the percentage fee protocol ensures that the standing trustee receives reasonable compensation in any given year from *all* of the many cases that he administers, not from any single case. Nor can we say this system is unfair to debtors who secure confirmation of a plan and complete all payments: while those debtors will pay a larger fee, they also benefit most from Chapter 13.

[20] Second, as to the Trustees’ argument that bad faith debtors will be encouraged by the absence of the percentage fee, Congress has designed other solutions to this problem. Notably, the requirement that the debtor make pre-confirmation payments, in and of itself, deters bad faith filings. In Soussis’s case, for instance, several of her earlier bankruptcy cases were dismissed within months of filing after the trustee informed the court that she failed to make the payments proposed by her plan. And Congress has devised other ways to discourage bad faith filings, including

by allowing courts to dismiss bankruptcy cases or deny confirmation based on evidence of bad faith, 11 U.S.C. §§ 1325(a)(3), 1307, or to deny return of the debtor’s property post-dismissal “for cause,” *id.* § 349(b)(3). In its 2005 bankruptcy reform legislation, Congress attempted to address the problem of repeat bankruptcy filers like Soussis. *See Pub. L. No. 109-8*, § 302(3), 119 Stat. at 75 (codified at 11 U.S.C. § 362(c)(3)) (providing that if a Chapter 13 debtor files a new case within one year after the prior case was dismissed, the automatic stay will end after 30 days, unless the court extends the stay). But any effort to further deter bad faith filings also risks making good faith filings more difficult. Moreover, percentage fees imposed on debtors in improper circumstances have the added downside of reducing the pool of money available to reimburse creditors.

[21] Congress, not the courts, strikes the balance between competing policy priorities. In this case, Congress has done so by requiring the trustee to collect pre-confirmation payments and directing the trustee to return those payments to the debtor—without deducting a percentage fee—if the plan is not confirmed. Reasonable minds may disagree about the wisdom of Congress’s choices as a matter of public policy. We are bound to apply the structure Congress has created as we understand it.

CONCLUSION

For these reasons, we hold that if a Chapter 13 plan is not confirmed, the trustee must return to the debtor all of the *443 sums collected, including the percentage fee, subject only to limitations set out in [Section 1326\(a\)\(2\)](#). This interpretation best harmonizes the texts of [Section 1326](#) and [Section 586](#); it best explains the differences between [Section 1326](#) and the parallel provisions for Chapter 12 and Chapter 11(V) bankruptcies; and it best comports with the trustee compensation framework, as reflected in the statutory language and history of the relevant statutes. Accordingly, we **REVERSE** the judgment of the District Court and **REMAND** the case with instructions to the District Court to enter judgment granting Soussis’s disgorgement motion.

All Citations

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Footnotes

- 1 When Soussis filed her Chapter 13 bankruptcy case in May 2019, the applicable limits were \$419,275 for debts owed to unsecured creditors and \$1,257,850 for debts owed to secured creditors. [Revision of Certain Dollar Amounts in the Bankruptcy Code Prescribed Under Section 104\(a\) of the Code](#), 84 Fed. Reg. 3488 (Feb. 12, 2019).
- 2 These criteria include, among others, that the plan was “proposed in good faith,” 11 U.S.C. § 1325(a)(3); that the value of the property to be distributed to unsecured creditors is equal to or greater than the amount that the unsecured creditors would receive in a Chapter 7 bankruptcy proceeding, *id.* § 1325(a)(4); and that the debtor “will be able to make all payments under the plan and to comply with the plan,” *id.* § 1325(a)(6).
- 3 “Recognizing that reality,” the Supreme Court has explained, Congress gave debtors the “nonwaivable right to convert a Chapter 13 case to one under Chapter 7 ‘at any time.’” [Harris](#), 575 U.S. at 514, 135 S.Ct. 1829 (quoting 11 U.S.C. § 1307(a)). In the Chapter 7 personal bankruptcy regime, the debtor must surrender all but a limited set of her assets, but she may shield from creditors her post-petition income. 11 U.S.C. §§ 541(a)(1), 542(a), 522. The Chapter 7 trustee then sells her assets and distributes the proceeds to creditors. *Id.* §§ 704(a)(1), 726.
- 4 If a plan is confirmed but the case is later dismissed or converted, the debtor cannot recover any payments she has made that have previously been distributed to creditors.

If the debtor has made payments under a confirmed plan and the trustee has not yet distributed them, those payments must be returned to the debtor when a case is converted, the Supreme Court has held. [Harris](#), 575 U.S. at 518, 135 S.Ct. 1829. Many courts have ruled that, if a case is dismissed rather than converted, undistributed payments must also be returned to the debtor. *See* 2 W. Homer Drake, Jr., Paul W. Bonapfel, & Adam M. Goodman, Chapter 13 Practice & Procedure § 20:9 (June 2024 update) (collecting cases); 11 U.S.C. § 349(b)(3) (providing that “[u]nless the court, for cause, orders otherwise, a dismissal of a case ... revests the property of the estate in the [debtor or other individual or entity] in which such property was vested immediately before the commencement of the case ...”).
- 5 The Department of Justice’s Handbook for Chapter 13 Standing Trustees instructs trustees that they may “collect the percentage fee upon receipt of [a] payment.” Handbook for Chapter 13 Standing Trustees at p. 2-3. On a monthly basis, the standing trustee must transfer the percentage fee to an “operating expense account.” *Id.* at p. 4-3. If at the end of the fiscal year the account contains excess fees, that excess is then sent to the U.S. Trustee System Fund, which is used to support the system as a whole. 28 U.S.C. §§ 586(e)(2), 589a. The Handbook does not take a position, however, as to whether the percentage fee must be returned if the case is dismissed or converted before confirmation. *See* Handbook for Chapter 13 Standing Trustees at p. 2-3 (instructing trustees to “reverse payment of the percentage fee that had been collected upon receipt if there is controlling law in the district requiring such reversal”).
- 6 Each fiscal year, the standing trustee must submit a list of anticipated expenses, which must be “reasonable, actual, necessary, relate[d] to the duties of the standing trustee[,] and ... supported by appropriate documentation.” Handbook for Chapter 13 Standing Trustees at p. 6-2. The U.S. Trustee may deny reimbursement for expenses that are not adequately justified. *See* 28 C.F.R. § 58.11(b).

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- 7 In these cases, Soussis either did not make pre-confirmation payments or paid only small amounts to the trustee before the case was dismissed upon a motion from the trustee. In two cases, the standing trustee retained a modest fee (\$51 and \$190, respectively), and Soussis did not seek disgorgement.
- 8 The standing trustee supervising Soussis's case also moved to dismiss the case, accusing Soussis of failing to provide him with the financial documents that she was required by statute to produce. The motion was never decided: as discussed below, Soussis moved to dismiss her own case before the Court heard the standing trustee's motion.
- 9 The Bankruptcy Court surmised that Soussis likely "sought to dismiss her case because of a change made to the New York Real Property Actions and Proceedings Law, effective December 23, 2019, which permits a defendant to raise the defense of lack of standing after a judgment of foreclosure has been entered." *In re Soussis*, 624 B.R. 559, 565 (Bankr. E.D.N.Y. 2020).
- 10 Since that dismissal, Soussis has filed two additional Chapter 13 bankruptcy petitions, both of which were dismissed before confirmation upon a motion by the standing trustee. January 19, 2024, Soussis's property was finally sold at a foreclosure auction, at which a subsidiary of the Bank submitted the winning bid. At that time, Soussis's arrearage on her mortgage totaled \$786,116.75, and she owed an additional \$261,968.40 in taxes, assessments, insurance, and property preservation costs. Her property is currently listed for sale online for \$879,800.
- 11 The Bankruptcy Court concluded that a motion for disgorgement is not the proper vehicle to challenge a standing trustee's percentage fee: Soussis should instead have objected to Macco's final report. See App'x at 18; *Fed. R. Bankr. P. 5009*. But the court elected to overlook the procedural defect and analyze the matter as if Soussis had followed the appropriate procedures.
- 12 In the Bankruptcy Court proceedings, Soussis also maintained in the alternative that Macco's fee was too high: she asked the Bankruptcy Court to set a "fair and reasonable fee" and direct Macco to return the rest. Special App'x at 23. During her subsequent appeal to the District Court, however, Soussis expressly abandoned the argument, and we therefore do not address it further on appeal. See *Soussis v. Macco*, No. 20-cv-05673, 2022 WL 203751, at *1 n.1 (E.D.N.Y. Jan. 24, 2022). In any event, the requirement that a trustee's fee be "reasonable," 11 U.S.C. § 330(a)(1), does not apply to the standing trustee's percentage fee. See *id.* § 326(b) (providing that standing trustee's percentage fee is not subject to Section 330); 28 U.S.C. § 586(e)(2) (explaining how the standing trustee's percentage fee is calculated).

Separately, Soussis contended that Macco breached his fiduciary duty to her when he collected his percentage fees from the pre-confirmation payments, and she asserted a claim against him under the Federal Tort Claims Act, seeking to recover her attorney's fees as damages. See *In re Soussis*, 624 B.R. at 564; *Soussis*, 2022 WL 203751, at *2. Because she does not brief this issue on appeal, we treat it too as abandoned. See *McCarthy v. SEC*, 406 F.3d 179, 186 (2d Cir. 2005).

- 13 Section 586 provides in relevant part:

[The standing trustee] shall collect such percentage fee from all payments received by such individual under plans in the cases under subchapter V of chapter 11 or chapter 12 or 13 of title 11 for which such individual serves as standing trustee.

28 U.S.C. § 586(e)(2).

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14 Section 1326 provides in relevant part:

(a) (1) Unless the court orders otherwise, the debtor shall commence making payments not later than 30 days after the date of the filing of the plan or the order for relief, whichever is earlier, in the amount--

(A) proposed by the plan to the trustee;

....

(2) A payment made under paragraph (1)(A) shall be retained by the trustee until confirmation or denial of confirmation. If a plan is confirmed, the trustee shall distribute any such payment in accordance with the plan as soon as is practicable. If a plan is not confirmed, the trustee shall return any such payments not previously paid and not yet due and owing to creditors pursuant to paragraph (3) to the debtor, after deducting any unpaid claim allowed under section 503(b).

....

(b) Before or at the time of each payment to creditors under the plan, there shall be paid--

(1) any unpaid claim of the kind specified in section 507(a)(2) of this title;

(2) if a standing trustee appointed under section 586(b) of title 28 is serving in the case, the percentage fee fixed for such standing trustee under section 586(e)(1)(B) of title 28

11 U.S.C. § 1326(a)-(b).

15 In other circumstances, as discussed below, a debtor must make payments “directly to” creditors before confirmation. 11 U.S.C. § 1326(a)(1)(B)–(C). Those circumstances are not present here.

16 This reading is also consistent with Section 330(c) of title 11, regarding trustee compensation. It reads: “Unless the court orders otherwise, in a case under [C]hapter ... 13 of this title the compensation paid to the trustee serving in the case shall not be less than \$5 per month from any distribution under the plan during the administration of the plan.” 11 U.S.C. § 330(c). That Congress tied the \$5 minimum to each “distribution under the plan” demonstrates its expectation that trustees would collect their fees from distributions to creditors. Indeed, Section 330(c) was added to title 11 by the same bill that added Section 1326(a). See Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 434(c), 98 Stat. 333, 370.

17 The Federal Rules of Bankruptcy Procedure require debtors to use Official Form 113 “unless the court has adopted a local form[.]” Fed. R. Bankr. P. 3015(c)(1); see also U.S. Courts, Official Form 113 Committee Note (Dec. 1, 2017), <https://perma.cc/T64S-5J9M> (“Official Form 113 is new and is the required plan form in all chapter 13 cases, except to the extent that Rule 3015(c) permits the use of a Local Form.”). Many districts have adopted local forms and these generally follow the same structure as that used by the Official Form 113. The Eastern District of New York’s local form, like Official Form 113, lists the percentage fee among other “fees and priority claims,” such as attorney’s fees, that are covered by plan payments. See E.D.N.Y. Chapter 13 Model Plan § 4.2. (effective Dec. 1, 2024), <https://perma.cc/L7BL-3RY2>. It does not ask the debtor to specify in the form the amount that will be required for the percentage fee. *Id.*

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- 18 The amount of the percentage fee is likewise determined by the proposed plan, because the fee is a set percentage of the payments the trustee receives and disburses to creditors on the debtor's behalf. 28 U.S.C. § 586(e)(1)–(2). If the debtor proposes larger payments to the trustee, the trustee collects a larger fee.
- 19 Paragraph (3) reads: “Subject to [S]ection 363, the court may, upon notice and a hearing, modify, increase, or reduce the payments required under [Section 1326(a)] pending confirmation of a plan.” 11 U.S.C. § 1326(a)(3).
- 20 Even if she had made such payments, they would be made “directly to” creditors, 11 U.S.C. § 1326(a)(1)(B)–(C), and might not be subject to the percentage fee at all, see 28 U.S.C. § 586(e)(2) (permitting the trustee to collect his percentage fee only from “payments received by [the trustee]”).
- 21 To determine whether a “modifier at the beginning or end of a series of terms modifies all the terms[,]” courts have applied two contradictory rules: the “last antecedent rule” and the “series qualifier canon[.]” *United States v. Lockhart*, 749 F.3d 148, 152 (2d Cir. 2014), *aff’d*, 577 U.S. 347, 136 S.Ct. 958, 194 L.Ed.2d 48 (2016). The “last antecedent rule” posits that “a limiting clause or phrase should ordinarily be read as modifying only the noun or phrase that it immediately follows.” *Id.* (internal quotation marks omitted). The “series qualifier canon,” on the other hand, sets the opposite rule: “a modifier at the beginning or end of a series of terms modifies all the terms.” *Id.* (internal quotation marks omitted). The series qualifier canon generally prevails when, as is true here, “there is ‘no reason consistent with any discernible purpose of the statute to apply’ the limiting phrase to the last antecedent alone.” *United States v. Loyd*, 886 F.3d 686, 688 (8th Cir. 2018) (quoting *United States v. Bass*, 404 U.S. 336, 341, 92 S.Ct. 515, 30 L.Ed.2d 488 (1971)). It has particular force if the statute includes “nouns or verbs in a series,” *Corsair Special Situations Fund, L.P. v. Pesiri*, 863 F.3d 176, 189 n.2 (2d Cir. 2017) (Leval, J., concurring) (internal quotation marks omitted), such as “previously paid” and “due and owing.”
- 22 The exception for amounts “previously paid ... [or] due and owing to creditors pursuant to paragraph (3)” would, if read literally, apply in very few cases. One leading treatise suggests that trustees may withhold repayment under this provision only if a “specific order modifying payments to those creditors has previously been entered by the court [under paragraph (3)] and the trustee has not made any payments the trustee was ordered to make.” 8 Collier ¶ 1326.02[2][c][i]. We need not decide the precise contours of the exception here because we do not think the clause covers the percentage fee under any reasonable interpretation.

We note for completeness, however, that the final text of the clause—particularly the confusing reference to paragraph (3)—may simply be an unintended result of a complex legislative process. As discussed, the phrase “not previously paid and not yet due and owing to creditors pursuant to paragraph (3)” was added to Section 1326(a)(2) in the 2005 bankruptcy reform legislation. Before its enactment, Senator Chuck Grassley introduced several versions of the same bill over a multi-year period. In the 1999 version that he introduced, the relevant section read:

(2) A payment made [in the pre-confirmation period] shall be retained by the trustee until confirmation, denial of confirmation, or paid by the trustee as adequate protection payments in accordance with paragraph (3) If a plan is not confirmed, the trustee shall return any such payments not previously paid to creditors pursuant to paragraph (3) to the debtor, after deducting any unpaid claim allowed under section 503(b).

(3) (A) As soon as is practicable, and not later than 40 days after the filing of the case, the trustee shall—

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(i) pay from payments made under this section the adequate protection payments proposed in the plan;

....

(B) The court may, upon notice and a hearing, modify, increase, or reduce the payments required under this paragraph pending confirmation of a plan.

S. 625, 106th Cong. § 309(c)(2) (1999). In that bill, the phrase “payments previously paid to creditors pursuant to paragraph (3)” unmistakably referred only to pre-confirmation adequate protection payments.

The next year, for reasons that are not apparent, much of paragraph (3) was relocated to paragraph (1), and the bill's language was also revised to provide that adequate protection payments should go directly to creditors, rather than to the trustee. S. 3186, 106th Cong. § 309(c)(2) (2000). This revision left in paragraph (3) only the current provision, which allows the bankruptcy court to modify the pre-confirmation payments. *Id.*; see 11 U.S.C. § 1326(a)(3). Nevertheless, when Congress made this change to paragraph (3), it did not revise the previous paragraph's reference to paragraph (3). This may have reflected a deliberate choice by Congress to narrow the meaning of the phrase “previously paid ... to creditors pursuant to paragraph (3),” but it also may have reflected simply an oversight in amendment process. Either way, it does not affect our conclusion here.

23 The most common administrative expense in a Chapter 13 case is the debtor's attorney fee. See Chapter 13 Practice & Procedure § 6:6. Other possible expenses include an ad hoc trustee's fee; administrative expenses arising from conversion from another chapter; costs resulting from the debtor's failure to make adequate protection payments or payments on a lease; and the expenses of operating the debtor's business. See *id.*; 11 U.S.C. § 503(b).

24 Its ambiguity is demonstrated by the varying interpretations of the term that have been adopted by federal courts. See, e.g., *In re Acevedo*, 497 B.R. at 122 (describing different possible constructions of Section 586(e)(2) and concluding that the statute “requires the Trustee to collect and hold the percentage fees pending plan confirmation”); *In re Miranda*, 2001 WL 1538003, at *2 (B.A.P. 10th Cir. 2001) (concluding that Section 586(e)(2) “specifies the amounts upon which the percentage fee shall be computed, but it is silent with regard to ... what effect pre-confirmation dismissal or conversion may have on the standing trustee's entitlement to her percentage fee”); *In re Harmon*, No. 1:19-BK-01424-TLM, 2021 WL 3087744, at *8 (B.A.P. 9th Cir. July 20, 2021) (holding that the “plain meaning of ‘shall collect such percentage fee’” in Section 586(e)(2) is that “a standing trustee obtains the fee upon receipt of each plan payment”). It seems fair to expect that if there were no ambiguity, greater uniformity would prevail.

25 See Pub. L. No. 95-598, §§ 586(e)(2), 1302(e)(2), 92 Stat. 2549, 2646, 2664 (1978) (“[The standing trustee] shall collect such percentage fee from all payments under plans in the [Chapter 13 cases] for which such individual serves as standing trustee.”) For ease of reading, we place citations to the relevant public laws in this section and the next one in footnotes.

26 See Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 113(c), 100 Stat. 3088, 3093; Small Business Reorganization Act of 2019, Pub. L. No. 116-54, § 4(b)(1)(D)(ii), 133 Stat. 1079, 1086.

In 1986, when Congress amended Section 586(e)(2) to apply to Chapter 12 trustees, it also revised the provision to read: “[The standing trustee] shall collect such percentage fee from all payments *received by [the trustee]* under plans” Pub. L. No. 99-554, § 113(c), 100 Stat. at 3093. The Trustees maintain that

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Congress's choice to replace "payments under plans" with "payments received by [the trustee] under plans" indicates that Congress wanted the standing trustee to collect the percentage fee upon *receipt* of the payment (whether before or after confirmation) and to keep that fee if the plan was not confirmed. The Trustees cite no legislative history to support this interpretation, however, and we do not think the text of the provision itself warrants such an expansive reading.

If Congress had any particular purpose when it added the phrase "received by [the trustee]," it seems more likely that it intended to clarify that the percentage fee is collected only from payments the trustee *received*—i.e., payments that the trustee distributed to creditors on behalf of the debtor, but not amounts the debtor paid directly to creditors. Before this amendment, lower courts were split as to "whether the percentage fee [was] to be applied to certain payments made by debtors directly to creditors or other parties rather than through the trustee, sometimes called payments 'outside the plan.'" 8 Collier ¶ 1302.05[c] (describing divide in courts before 1986). After the 1986 enactment, "most courts have permitted debtors to pay some creditors directly without paying the trustee a percentage fee on those payments." *Id.*; see, e.g., *In re Wagner*, 36 F.3d 723, 728 (8th Cir. 1994) (describing the legislative history and holding that Section 586(e)(2) "means what it says and requires trustee's fees only on those payments 'received by' the trustee").

27 Pub. L. No. 98-353, § 318(a), 98 Stat. at 357.

28 *Id.*

29 Pub. L. No. 99-554, § 255, 100 Stat. at 3105.

30 The complete text of Section 1226(a) is shown below. The language that differs from that used in Section 1326(a)(2) is underlined.

Payments and funds received by the trustee shall be retained by the trustee until confirmation or denial of confirmation of a plan. If a plan is confirmed, the trustee shall distribute any such payment in accordance with the plan. If a plan is not confirmed, the trustee shall return any such payments to the debtor, after deducting—

(1) any unpaid claim allowed under section 503(b) of this title; and

(2) if a standing trustee is serving in the case, the percentage fee fixed for such standing trustee.

Pub. L. No. 99-554, § 366, 100 Stat. at 3111.

The Trustees emphasize that "[t]he first sentence of [Section 1226(a)] provides that 'payments and funds received by the [Chapter 12] trustee shall be retained,'" while Section 1326(a)(2) provides that "[a] payment made under [Section 1326(a)] shall be retained." Macco Br. at 19 (emphasis added); see also U.S. Trustee Br. at 28. Therefore, they say, the two sections must involve different sources of money: Section 1226(a) applies to pre-confirmation "[p]ayments and funds," while Section 1326(a)(2) applies to pre-confirmation payments under Section 1326(a), that is, "payments ... proposed by the plan." They further posit that this difference explains why Congress might have seen a need to explicitly allow for the deduction of the trustee's percentage fee in Section 1226(a), but not in Section 1326(a)(2). We disagree. The difference in Section 1226(a)'s opening clause ("payments and funds") more plausibly reflects that because Section 1226 does not require a debtor to make any pre-confirmation payments at all, the debtor has more flexibility about those payments or funds he gives to the trustee before confirmation. But the rest of Section 1226(a) is copied

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almost verbatim from [Section 1326\(a\)\(2\)](#), and it makes clear that the term “payments” generally includes both [Section 503\(b\)](#) administrative fees and the trustee's percentage fee.

31 See Pub. L. No. 99-554, § 255, 100 Stat. at 3112 ([Section 1226\(b\)–\(c\)](#)); Pub. L. No. 95-598, § 1326(a)–(b), 92 Stat. 2549, 2657 (parallel provisions in [Section 1326](#), which were in 1984 moved to [Section 1326\(b\)–\(c\)](#)).

32 Pub. L. No. 99-554, § 230, 100 Stat. at 3103.

33 Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 307, 108 Stat. 4106, 4135.

34 Pub. L. No. 109-8, § 309(c)(2), 119 Stat. at 83.

35 See Pub. L. No. 116-54, § 2(a), 133 Stat. at 1079.

36 The Trustees also point out that Chapters 13, 12, and 11(V) were “created for different purposes, and they operate differently in significant ways.” U.S. Trustee's Br. at 27. For instance, while pre-confirmation payments are mandatory in Chapter 13 cases, [11 U.S.C. § 1326\(a\)\(1\)](#), they are not in Chapter 12 or Chapter 11(V) cases, see §§ 1201–32; 1181–95. If anything, however, the differences among the chapters tend to explain why Congress might have created different rules for the standing trustee's fee in different categories of proceedings. For instance, because pre-confirmation payments are voluntary in Chapter 12 and Chapter 11(V) bankruptcies, Congress may have concluded that it was reasonable to require debtors who elected to make such payments to pay the trustee's fee for administering them.

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Declined to Extend by [In re Boy Scouts of America](#), 3rd Cir.(Del.), May 13, 2025

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:

[1] 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;

[2] 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

[3] "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.

West Headnotes (44)

[1] Bankruptcy 🗝️ "Good faith."

Good intentions, such as to protect a company's brand or comprehensively resolve litigation, do not suffice, alone, to constitute good faith in filing a Chapter 11 petition; what counts to access the Bankruptcy Code's safe harbor is to meet its intended purposes. [11 U.S.C.A. § 1112\(b\)](#).

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[2] **Bankruptcy** 🗝️ **Good Faith; Motive**

Only a putative debtor in financial distress may access the Bankruptcy Code's safe harbor by filing a bankruptcy petition.

Court of Appeals reviews for an “abuse of discretion” the bankruptcy court's denial of motions to dismiss a Chapter 11 petition for lack of good faith; 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. 11 U.S.C.A. § 1112(b).

2 Cases that cite this headnote

[3] **Corporations and Business**

Organizations 🗝️ **Spin-Offs, Split-Offs, and Corporate Divisions**

Under Texas law, a “divisional merger” splits a legal entity into two, divides its assets and liabilities between the two new entities, and terminates the original entity. *Tex. Bus. Org. Code* § 10.001 et seq.

1 Case that cites this headnote

[7] **Bankruptcy** 🗝️ **Conclusions of law; de novo review**

Bankruptcy 🗝️ **Clear error**

Court of Appeals gives fresh, that is, plenary or de novo, review to a bankruptcy court's conclusion of law and reviews for clear error findings of fact leading to the decision.

1 Case that cites this headnote

[4] **Bankruptcy** 🗝️ **"Bad faith."**

Bankruptcy 🗝️ **Realistic possibility of reorganization**

In the Fourth Circuit, a court can only dismiss a Chapter 11 petition for lack of good faith on a showing of debtor's subjective bad faith and objective futility of any possible reorganization. 11 U.S.C.A. § 1112(b).

3 Cases that cite this headnote

[8] **Bankruptcy** 🗝️ **Particular cases and issues**

On appeal from a bankruptcy court's decision, facts subject to clear-error review include those that are basic, historical, and narrative events elicited from evidence presented at trial, and those that are inferred, which are drawn from basic facts and are permitted only when, and to extent that, logic and human experience indicate probability that certain consequences can and do follow from basic facts; these are distinguished from an “ultimate fact,” which is legal concept with factual component, and examples include negligence or reasonableness.

1 Case that cites this headnote

[5] **Bankruptcy** 🗝️ **Settlement, adjustment, or enforcement of claims**

Bankruptcy Code 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 and, under certain conditions, may also channel claims against third parties affiliated with the debtor. 11 U.S.C.A. § 524(g).

[9] **Bankruptcy** 🗝️ **Scope of review in general**

Reviewing ultimate fact decided by the bankruptcy court, the Court of Appeals separates its distinct factual and legal elements and applies appropriate standard to each component.

[6] **Bankruptcy** 🗝️ **Discretion**

[10] **Bankruptcy** 🗝️ **Conclusions of law; de novo review**

In re LTL Management, LLC, 64 F.4th 84 (2023)

Bankruptcy 📁 Particular cases and issues

Concluding that a bankruptcy petition is filed in good faith is an ultimate fact, for purposes of appellate review; 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.

1 Case that cites this headnote

- [11] **Bankruptcy** 📁 Conclusions of law; de novo review

Bankruptcy 📁 Particular cases and issues

Bankruptcy court's determination of a debtor's financial distress, like the broader good-faith inquiry of which it is a part, 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.

- [12] **Bankruptcy** 📁 Good Faith; Motive

Chapter 11 petitions are subject to dismissal unless filed in good faith. 11 U.S.C.A. § 1112(b).

1 Case that cites this headnote

- [13] **Bankruptcy** 📁 Good Faith; Motive

Lack of good faith constitutes "cause" for dismissal of Chapter 11 petition, though it does not fall into one of the examples of cause specifically listed in the Bankruptcy Code. 11 U.S.C.A. § 1112(b).

- [14] **Bankruptcy** 📁 Good Faith; Motive

Good-faith requirement for a Chapter 11 petition, though not set forth in the text of the Bankruptcy Code, is grounded in the equitable nature of

bankruptcy and the purposes underlying Chapter 11 of the Code. 11 U.S.C.A. § 1112(b).

- [15] **Bankruptcy** 📁 Proceedings

Once at issue, burden to establish good faith of Chapter 11 petition is on debtor. 11 U.S.C.A. § 1112(b).

- [16] **Bankruptcy** 📁 Good Faith; Motive

In determining whether Chapter 11 petition was filed in good faith, courts 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. 11 U.S.C.A. § 1112(b).

1 Case that cites this headnote

- [17] **Bankruptcy** 📁 "Good faith."

Though Chapter 11 debtor's subjective intent may be relevant, good faith in filing bankruptcy petition falls more on objective analysis of whether debtor has sought to step outside equitable limitations of Chapter 11. 11 U.S.C.A. § 1112(b).

- [18] **Bankruptcy** 📁 "Good faith."

In determining whether Chapter 11 petition was filed in good faith, two inquiries are particularly relevant: (1) whether the petition serves a valid bankruptcy purpose, and (2) whether it is filed merely to obtain a tactical litigation advantage. 11 U.S.C.A. § 1112(b).

2 Cases that cite this headnote

- [19] **Bankruptcy** 📁 "Good faith."

In context of determining whether Chapter 11 petition was filed in good faith, valid bankruptcy purposes include preserving going concern or maximizing value of debtor's estate. 11 U.S.C.A. § 1112(b).

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[20] **Bankruptcy** 🔑 "Good faith."

In context of determining whether Chapter 11 petition was filed in good faith, a valid bankruptcy purpose assumes a debtor in financial distress. 11 U.S.C.A. § 1112(b).

[9 Cases that cite this headnote](#)

[21] **Bankruptcy** 🔑 "Bad faith."

Absent financial distress, there is no reason for Chapter 11 and no valid bankruptcy purpose, warranting dismissal of petition for lack of good faith; if a debtor has no need to rehabilitate or reorganize, its petition cannot serve the rehabilitative purpose for which Chapter 11 was designed. 11 U.S.C.A. § 1112(b).

[2 Cases that cite this headnote](#)

[22] **Bankruptcy** 🔑 Reorganization cases

To say that a debtor must be in financial distress to file a Chapter 11 petition is not to say it must necessarily be insolvent. 11 U.S.C.A. § 1112(b).

[1 Case that cites this headnote](#)

[23] **Bankruptcy** 🔑 Good Faith; Motive

In evaluating motion to dismiss Chapter 11 petition as having not been filed in good faith, "good-faith gateway" asks whether the debtor faces the kinds of problems that justify Chapter 11 relief. 11 U.S.C.A. § 1112(b).

[2 Cases that cite this headnote](#)

[24] **Bankruptcy** 🔑 Reorganization cases

Bankruptcy 🔑 Good Faith; Motive

Though insolvency is not strictly required for a Chapter 11 filing, and no list is exhaustive of all factors which could be relevant when analyzing a particular debtor's good faith in filing for Chapter 11 relief, court cannot ignore that

debtor's balance sheet insolvency or insufficient cash flows to pay liabilities, or future likelihood of these issues occurring, are likely always relevant. 11 U.S.C.A. § 1112(b).

[1 Case that cites this headnote](#)

[25] **Bankruptcy** 🔑 Good Faith; Motive

In determining whether Chapter 11 petition was filed in good faith, court considers, on case-by-case basis, all relevant facts in light of the purposes of the Bankruptcy Code. 11 U.S.C.A. § 1112(b).

[1 Case that cites this headnote](#)

[26] **Bankruptcy** 🔑 "Good faith."

In determining whether Chapter 11 petition was filed in good faith, financial distress of debtor must not only be apparent, but it must be immediate enough to justify the Chapter 11 filing. 11 U.S.C.A. § 1112(b).

[6 Cases that cite this headnote](#)

[27] **Bankruptcy** 🔑 "Good faith."

Attenuated possibility, standing alone, that debtor may have to file for bankruptcy in the future does not establish "good faith" in filing Chapter 11 petition. 11 U.S.C.A. § 1112(b).

[28] **Bankruptcy** 🔑 "Good faith."

For purposes of determining whether Chapter 11 petition was filed in good faith, in particular, whether debtor's financial distress was both apparent and immediate enough to justify a filing, the Bankruptcy Code contemplates the need for early access to bankruptcy relief to allow debtor to rehabilitate its business before it is faced with hopeless situation. 11 U.S.C.A. § 1112(b).

[2 Cases that cite this headnote](#)

In re LTL Management, LLC, 64 F.4th 84 (2023)

[29] **Bankruptcy** 📌 "Good faith."

In determining whether Chapter 11 petition was filed in good faith, a "financially troubled" debtor facing mass tort liability may require bankruptcy to enable a continuation of its business and to maintain access to the capital markets, even before it is insolvent. 11 U.S.C.A. § 1112(b).

[30] **Bankruptcy** 📌 "Good faith."

Bankruptcy Code's encouragement of early filing does not open the door to premature filing, for purposes of determining whether Chapter 11 petition was filed in good faith; though this may be a fine line in some cases, the bankruptcy system puts courts, vested with equitable powers, in the best position to draw it. 11 U.S.C.A. § 1112(b).

[31] **Bankruptcy** 📌 Good Faith; Motive

When financially troubled debtors seek a chance to remain in business through the filing of a Chapter 11 petition, the exercise of the considerable powers vested in a debtor by the Bankruptcy Code is justified. 11 U.S.C.A. § 1112(b).

[32] **Bankruptcy** 📌 In general; nature and purpose

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.

[33] **Bankruptcy** 📌 In general; nature and purpose

Chapter 11 of the Bankruptcy Code was meant to deal with the reorganization of a financially distressed enterprise.

[34] **Bankruptcy** 📌 "Good faith."

When financial distress is present, bankruptcy may be an appropriate forum for a debtor to address mass tort liability, for purposes of determining whether a Chapter 11 petition was filed in good faith. 11 U.S.C.A. § 1112(b).

4 Cases that cite this headnote

[35] **Bankruptcy** 📌 "Good faith."

Although mass tort liability may push a debtor to the brink, to measure the debtor's distance to it, for purposes of determining the debtor's good faith in filing a Chapter 11 petition, courts must always weigh not just the scope of liabilities the debtor faces, but also the capacity it has to meet them. 11 U.S.C.A. § 1112(b).

[36] **Bankruptcy** 📌 "Good faith."

In evaluating, under the totality of the facts and circumstances, the good faith of Chapter 11 debtor, an indirect subsidiary of manufacturer of talc-based astringent powder which, through corporate restructuring, had assumed responsibility for manufacturer's talc-related liabilities, the Court of Appeals would consider only the financial condition of debtor, not its pre-bankruptcy predecessor which, due to divisional merger under Texas law, no longer existed; only debtor was in bankruptcy and subject to its good-faith requirement, and so predecessor's financial condition was relevant only to the extent that it informed the court's view of the financial condition of debtor itself. 11 U.S.C.A. § 1112(b); Tex. Bus. Org. Code § 10.00 et seq.

[37] **Bankruptcy** 📌 Effect of state law in general

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State-law property interests should generally be given same effect inside and outside bankruptcy.

[38] Bankruptcy ➡ Effect of state law in general

Unless some federal interest requires a different result, there is no reason why state-law property interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.

[39] Bankruptcy ➡ Application of state or federal law in general

General expectation of state law and of the Bankruptcy Code is that courts respect entity separateness absent compelling circumstances calling equity into play.

1 Case that cites this headnote

[40] Bankruptcy ➡ Construction and Operation

Bankruptcy Code is designed in important part to protect and distribute a debtor's assets to satisfy its liabilities.

[41] Bankruptcy ➡ "Good faith."

Chapter 11 debtor, an indirect subsidiary of manufacturer of talc-based astringent powder which, through corporate restructuring, had assumed responsibility for manufacturer's talc-related liabilities, was not in financial distress, and so did not file its petition in good faith, warranting dismissal; despite massive talc-related liabilities totaling \$4.5 billion in five-plus years of litigation to date, funding support agreement gave debtor right to cause its corporate parent and another affiliate, both highly creditworthy counterparties, to pay it cash of \$61.5 billion or more to satisfy talc-related costs and normal-course expenses, such that debtor was, on petition date, highly solvent with access to cash to meet comfortably its liabilities as they came due for the foreseeable future,

and, in light of pre-bankruptcy litigation history, court could not assume that most talc claims would go to trial, given possibility of meaningful settlement or successful defense and dismissal. 11 U.S.C.A. § 1112(b).

1 Case that cites this headnote

[42] Bankruptcy ➡ "Bad faith."

It is not "bad faith" to seek to gain an advantage from declaring bankruptcy. 11 U.S.C.A. § 1112(b).

[43] Bankruptcy ➡ In General; Grounds in General

"Unusual circumstances" did not preclude dismissal of petition of Chapter 11 debtor, an indirect subsidiary of manufacturer of talc-based astringent powder which, through corporate restructuring, had assumed responsibility for manufacturer's talc-related liabilities, where, 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; no "reasonable justification" validated the missing requirement of financial distress, and the Court of Appeals could not currently see how debtor's lack of financial distress could be overcome. 11 U.S.C.A. § 1112(b)(2).

4 Cases that cite this headnote

[44] Bankruptcy ➡ Reorganization cases

Given the ability of Chapter 11 of the Bankruptcy Code to redefine fundamental rights of third parties, only those facing financial distress can call on bankruptcy's tools to do so. 11 U.S.C.A. § 1112(b).

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In re LTL Management, LLC, 64 F.4th 84 (2023)

*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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In re LTL Management, LLC, 64 F.4th 84 (2023)

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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.

[1] [2] 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.

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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-

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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

[3] 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

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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).

[4] 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).

[5] 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.

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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

[6] [7] 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** [8] [9] 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.

[10] [11] 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. CWCapital 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,

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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

[12] [13] [14] 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.”).

[15] [16] [17] 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).

[18] [19] [20] “[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

[21] 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

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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).

[22] 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.

[23] [24] 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)).

[25] 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.

[26] [27] [28] [29] 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.

[30] 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

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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

[31] [32] 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).

[33] 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).

[34] 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.

[35] 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).

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

[36] 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.

[37] [38] 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 talc 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).

[39] 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.

[40] 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.

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[41] 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 "JJC 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

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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 [t]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

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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 [42]** 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

[43] 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

[44] 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

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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

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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

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- 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),

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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?

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- 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.

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In re Bestwall LLC, 658 B.R. 348 (2024)

658 B.R. 348
United States Bankruptcy Court, W.D. North Carolina,
Charlotte Division.

IN RE: BESTWALL LLC, Debtor.

Case No. 17-31795

I

Signed February 21, 2024

Synopsis

Background: Following denial of claimants and official committee of asbestos claimants motion to dismiss debtor's Chapter 11 case as having been filed in bad faith or, alternatively, for change of venue, [605 B.R. 43](#), claimants and committee moved to reconsider.

Holdings: The Bankruptcy Court, [Laura T. Beyer](#), Chief Judge, held that:

[1] law of case prevented reconsideration of prior decision that resolving asbestos claims was valid reorganizational purpose;

[2] divestment rule prevented Court from addressing issues on interlocutory appeal; and

[3] financial distress was not prerequisite for bankruptcy subject matter jurisdiction pursuant to Constitution.

Motion denied.

Procedural Posture(s): Motion for Reconsideration; Motion to Dismiss for Lack of Subject Matter Jurisdiction.

West Headnotes (27)

[1] **Bankruptcy** ➡ **Proceedings**

Law of case prevented reconsideration of bankruptcy court's prior determinations, on motion to dismiss, that resolving asbestos claims was valid reorganizational purpose for debtor

with resources with which to reorganize, and that Chapter 11 petition was not objectively futile based on volume of current asbestos claims coupled with number of claims to be filed, since claimant did not cite to substantially different evidence sufficient to cause court to revisit its prior opinion and order. [11 U.S.C.A. §§ 524\(g\), 1112\(b\)](#).

[2] **Courts** ➡ **Previous Decisions in Same Case as Law of the Case**

Pursuant to the law of the case doctrine and in the interest of finality, when a court decides upon a rule of law, that decision should continue to govern the same issues in subsequent stages in the same case.

[3] **Courts** ➡ **Previous Decisions in Same Case as Law of the Case**

To determine extent to which law of case governs, court first must determine what issues it decided in opinion and order and then decide whether any exceptions apply that might justify departing from law of case.

[4] **Bankruptcy** ➡ **Settlement, adjustment, or enforcement of claims**

A Chapter 11 debtor with substantial asbestos liabilities may obtain a channeling injunction that diverts all asbestos claims, current and future, to a trust established by the debtor's reorganization plan and funded by the debtor. [11 U.S.C.A. § 524\(g\)](#).

[5] **Federal Courts** ➡ **Effect of Transfer of Cause or Proceedings Therefor**

Generally, the timely filing of a notice of appeal confers jurisdiction on the court of appeals and divests the district court of its control over those aspects of the case involved in the appeal; the purpose of the general rule is to avoid the

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confusion of placing the same matter before two courts at the same time and to preserve the integrity of the appeal process.

as to interfere with or effectively circumvent the appeal process.

[6] **Bankruptcy** 🗝️ Effect of Transfer

Bankruptcy court is divested of jurisdiction with respect to matters raised in an appeal to a higher court.

[10] **Federal Courts** 🗝️ Interlocutory or defective appeal

Interlocutory appeals do not divest lower courts of jurisdiction.

[7] **Bankruptcy** 🗝️ Effect of Transfer

Divestment rule prevented bankruptcy court, on claimant's motion for reconsideration of prior denial of motion by official committee of asbestos claimants to dismiss, from addressing issues on interlocutory appeal of that denial, since crux of both motions was determination of whether Chapter 11 case should be dismissed as bad faith filing, reasoning previously argued and decided was same as reasoning subsequently argued, i.e., case lacked valid bankruptcy purpose, manipulated Bankruptcy Code and bankruptcy jurisdiction, and deprived victims of jury trial rights, and exercising jurisdiction over motion would interfere with or effectively circumvent appeal process. 11 U.S.C.A. §§ 524(g), 1112(b).

[11] **Federal Courts** 🗝️ Timeliness issues

Issues of subject matter jurisdiction may be resurrected at any point in litigation.

[12] **Bankruptcy** 🗝️ Limited, in personam, and in rem jurisdiction

Federal Courts 🗝️ Limited jurisdiction; jurisdiction as dependent on constitution or statutes

Bankruptcy court and all federal courts have limited jurisdiction and can exercise power only as authorized by Constitution and Congress.

[8] **Bankruptcy** 🗝️ Effect of Transfer

When a notice of appeal has been filed in a bankruptcy case, the bankruptcy court retains jurisdiction to address elements of the bankruptcy proceeding that are not the subject of that appeal.

[13] **Federal Courts** 🗝️ Subject-matter jurisdiction in general

Federal Courts 🗝️ Grounds or Exclusions of Jurisdiction in General

Subject matter jurisdiction sets outer limit of a federal court's authority, and nonjurisdictional rules control within jurisdictional boundaries.

[9] **Federal Courts** 🗝️ Effect of Transfer of Cause or Proceedings Therefor

Once an appeal is pending, it is imperative for a lower court to not exercise jurisdiction over those issues which, although not themselves expressly on appeal, nevertheless so impact the appeal so

[14] **Bankruptcy** 🗝️ Bankruptcy Jurisdiction

Bankruptcy Clause of the Constitution determines limits of subject matter jurisdiction for bankruptcy. U.S. Const. art. 1, § 8, cl. 4.

[15] **Federal Courts** 🗝️ Power of Congress to establish courts and define their jurisdiction

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Congress determines subject matter jurisdiction within any limitations imposed by the Constitution.

bankruptcy extended to all cases filed under Bankruptcy Code. *U.S. Const. art. 1, § 8, cl. 4.*

[16] **Federal Courts** 🏛️ Presumptions and burden of proof

Party advocating in favor of a court's subject matter jurisdiction over a particular case or issue bears the burden of proof.

[21] **Bankruptcy** 🏛️ Bankruptcy Jurisdiction

Bankruptcy jurisdiction extends at least to all cases where the law causes to be distributed the property of the debtor among his creditors, and its greatest limit is a discharge of the debtor from his contracts. *U.S. Const. art. 1, § 8, cl. 4.*

[17] **Federal Courts** 🏛️ Subject-matter jurisdiction in general

Federal Courts 🏛️ Objections, Proceedings, and Determination in General

Federal Courts 🏛️ Timeliness issues

Subject matter jurisdiction cannot be defeated by equitable defenses because it can be raised at any time and is requirement for federal courts to exercise their power.

[22] **Bankruptcy** 🏛️ Jurisdictional provisions; courts and judges

All intermediate legislation, affecting substance and form of bankruptcy jurisdiction, but tending to further the great end of the subject—distribution and discharge—are in the competency and discretion of Congress. *U.S. Const. art. 1, § 8, cl. 4.*

[18] **Federal Courts** 🏛️ Waiver, estoppel, and consent

Concepts of consent, waiver, and estoppel do not apply to subject matter jurisdiction because it is created and limited by the Constitution and statutes.

[23] **Bankruptcy** 🏛️ Purpose

The “subject of Bankruptcies” is not, properly, anything less than the subject of the relations between an insolvent or non-paying or fraudulent debtor, and his creditors, extending to his and their relief. *U.S. Const. art. 1, § 8, cl. 4.*

[19] **Courts** 🏛️ Jurisdiction, dismissal, nonsuit, and summary judgment, rulings relating to

Federal Courts 🏛️ Timeliness issues

Neither laches nor the law of the case doctrine prevents review of a federal court's subject matter jurisdiction.

[24] **Bankruptcy** 🏛️ Purpose

Restructuring of debtor-creditor relations is at core of federal bankruptcy power. *U.S. Const. art. 1, § 8, cl. 4.*

[20] **Bankruptcy** 🏛️ Bankruptcy Jurisdiction

Financial distress was not prerequisite for bankruptcy subject matter jurisdiction pursuant to Constitution; subject matter jurisdiction for

[25] **Bankruptcy** 🏛️ Bankruptcy Jurisdiction

Insolvency is not a prerequisite for bankruptcy subject matter jurisdiction. *U.S. Const. art. 1, § 8, cl. 4.*

[26] **Bankruptcy** 🏛️ Who May Be a Debtor

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The bankruptcy requirements for debtor eligibility are not jurisdictional. 11 U.S.C.A. § 109.

[27] **Bankruptcy** 📌 Who May Be a Debtor

Bankruptcy case may commence even if debtor is not eligible under particular chapter. 11 U.S.C.A. §§ 109, 301.

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**ORDER DENYING THE MOTIONS TO DISMISS
OF CLAIMANTS WILSON BUCKINGHAM
AND ANGELIKA WEISS AND THE OFFICIAL
COMMITTEE OF ASBESTOS CLAIMANTS**

[Laura T. Beyer](#), United States Bankruptcy Judge

*351 This matter comes before the court on the February 17, 2023 Motion to Dismiss of Claimants Wilson Buckingham and Angelika Weiss (Dkt. 2882¹) (the “Buckingham Motion”) and the March 30, 2023 Official Committee of Asbestos Claimants’ Motion to Dismiss for Lack of Subject Matter Jurisdiction (Dkt. 2925) (the “Committee’s Motion”) (collectively the “Motions to Dismiss”). The court concludes that it has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334,² venue is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409, and this is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). Having reviewed and considered the Motions to Dismiss, the joinders, responses, and replies thereto, and after considering the arguments of counsel at the hearings on March 15, 2023 and May *352 17, 2023 and having announced its ruling on the Motions to Dismiss at a hearing on July 28, 2023, the court further finds and concludes that it should deny the Motions to Dismiss for the reasons that follow.

Facts and Procedural History

1. Bestwall LLC (the “Debtor”) filed a petition under Chapter 11 of the United States Bankruptcy Code (the “Bankruptcy Code”) on November 2, 2017. The Debtor’s pre-petition history was unusual and unusually brief. About three months prior to the petition date, the Debtor was created in a divisive merger corporate transaction pursuant to Texas state law that has come to be known as the “Texas Two-Step.” See Debtor’s Opposition to Third Motion to Dismiss Chapter 11 Case (Dkt. 2894) (“Debtor’s Response to the Buckingham Motion”) at

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3 (noting corporate restructuring on July 31, 2017); Michael A. Francus, *Texas Two-Stepping Out of Bankruptcy*, 120 MICH. L. REV. ONLINE 38, 40 (2022) (explaining divisive mergers). The transaction divided the Debtor's predecessor, Georgia-Pacific LLC ("Old GP" prior to the transaction), into two new entities, the Debtor and a new version of Georgia-Pacific LLC ("New GP"). Informational Brief of Bestwall LLC (Dkt. 12) at 7–8. The divisive merger imbued the Debtor with Old GP's asbestos liability and certain assets including a "funding agreement" with New GP that "ensures that the Debtor has the same financial resources and ability to satisfy asbestos claims as Old GP had prior to the 2017 Corporate Restructuring," while New GP took all of Old GP's other assets and liabilities.³ *Id.* at 8.

2. The Motions to Dismiss constitute the third and fourth motions to dismiss this bankruptcy case. On August 15, 2018, the Official Committee of Asbestos Claimants (the "Committee") filed a motion to dismiss this case as a bad faith filing pursuant to 11 U.S.C. § 1112(b)⁴ or, alternatively, to transfer venue of the case to Delaware (Dkt. 495) (the "First Motion to Dismiss"). The court entered its Memorandum Opinion and Order Denying the Official Committee of Asbestos Claimants' Motion for Dismissal, or Alternatively, Venue Transfer (Dkt. 891) (the "Opinion and Order") on July 29, 2019. *In re Bestwall LLC*, 605 B.R. 43 (Bankr. W.D.N.C. 2019). In its Opinion and Order, the court summarizes the two-prong standard for dismissing a Chapter 11 case as a bad faith filing established by the United States Court of Appeals for the Fourth Circuit (the "Fourth Circuit") in the *Carolin* case, which requires a determination that the case is both (i) objectively futile and (ii) filed in subjective bad faith. *Bestwall*, 605 B.R. at 48 (citing *Carolin Corp. v. Miller*, 886 F.2d 693, 700–01 (4th Cir. 1989)). Among other things, the court determined that "[a]ttempting to resolve asbestos claims through 11 U.S.C. § 524(g) is a valid reorganizational purpose, and filing for Chapter 11, especially in the context of an asbestos or mass tort case, need not be due to insolvency." *Id.* at 49. The court also stated that "[t]he volume of current asbestos claims that Bestwall faced as of the Petition Date, coupled with the projected number of claims to be *353 filed through 2050 and beyond, is sufficient financial distress for Bestwall to seek resolution under section 524(g) of the Bankruptcy Code" and that the asbestos-related claims could be "sufficiently addressed and fairly adjudicated through a section 524(g) trust." *Id.* at 49, 50. The court concluded that

because Bestwall has the resources with which to reorganize, this case is not objectively futile, it need not reach the issue of whether the case was filed in subjective bad faith, and dismissal was not appropriate under the Fourth Circuit's stringent two-prong dismissal standard. *Id.* at 50–51.

3. On August 12, 2019, the Committee filed a notice of appeal (Dkt. 917) of the Opinion and Order, a motion for leave to appeal (Dkt. 918), and a request for certification of direct appeal to the Fourth Circuit (Dkt. 920). This court approved the request for the direct appeal on September 11, 2019 in its Certification for Direct Appeal to the United States Court of Appeals for the Fourth Circuit Under 28 U.S.C. § 158(d) (2) (Dkt. 987) ("Certification for Direct Appeal"),⁵ and, in turn, the Committee filed its petition for direct appeal with the Fourth Circuit on October 11, 2019. On November 14, 2019, the Fourth Circuit denied the petition for direct appeal, and New GP opposed the Committee's motion for leave to appeal before the United States District Court for the Western District of North Carolina (the "District Court").

4. On February 3, 2023, the Committee filed a notice of supplemental authority (W.D.N.C. Dkt. 12⁶) ("Committee's Notice") bringing to the attention of the District Court the "pertinent and significant new authority" of the opinion of the United States Court of Appeals for the Third Circuit in the LTL Management case (the "LTL Opinion"). Committee's Notice at 2; see *LTL Mgmt., LLC v. Those Parties Listed on Appendix A to Complaint and John and Jane Does 1–1000 (In re LTL Mgmt., LLC)*, 64 F.4th 84 (3d Cir. 2023). Based on the LTL Opinion, the Committee urged the District Court to accept the pending notice of appeal (or grant the Committee's motion for leave to pursue an interlocutory appeal) so the Fourth Circuit would have a chance to consider the applicability of the *Carolin* standard to "a debtor that failed to exhibit financial distress prior to invoking the substantial protections of the Bankruptcy Code." Committee's Notice at 2. The Debtor responded (W.D.N.C. Dkt. 13) ("Debtor's Response to Committee's Notice") and asserted that nothing about the LTL Opinion changed the reasons why the District Court should "deny leave to appeal the interlocutory order denying the Committee's motion to dismiss Bestwall's bankruptcy case." Debtor's Response to Committee's Notice. The Debtor further opined that the LTL Opinion is based on a different standard and has no application to the appeal of the Opinion and Order. *Id.* at ¶ 3.

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*354 5. More recently in the District Court and based on the pleadings filed by the Committee in this case related to the Committee's Motion, the Debtor filed a motion for leave to file a statement regarding the Committee's change in position on the finality of the Opinion and Order (W.D.N.C. Dkt. 14) ("Debtor's Motion for Leave"). The Debtor points out that in support of the Committee's Motion in this court, the Committee argues that the Opinion and Order denying the First Motion to Dismiss is interlocutory contrary to its position in the District Court that the Opinion and Order is final and appealable as of right. Debtor's Motion for Leave. In addition, the Committee filed a second notice of supplemental authority (W.D.N.C. Dkt. 15) notifying the District Court of the recent decision of the United States Bankruptcy Court for the Southern District of Indiana dismissing Aearo's bankruptcy cases, which it argues supports the Committee's motion for leave to appeal the Opinion and Order. See In re Aearo Techs. LLC, Ch. 11 Case No. 22-02890, 2023 WL 3938436 (Bankr. S.D. Ind. June 9, 2023). Finally, the Debtor filed a notice of supplemental authority (W.D.N.C. Dkt. 17) ("Debtor's Notice") notifying the District Court of the Fourth Circuit's opinion in Bestwall LLC v. Off. Comm. of Asbestos Claimants (In re Bestwall LLC), 71 F.4th 168 (4th Cir. 2023). The Debtor argues that the Fourth Circuit's decision is relevant because it (1) confirmed that the two-pronged standard of Carolin remains the controlling law in this circuit for a motion to dismiss a Chapter 11 case as a bad faith filing;⁷ (2) reinforced the bankruptcy court's finding that this case is not objectively futile; and (3) rejected the Committee's "attempt to attack the preliminary injunction 'as a back-door way to challenge the propriety of the reorganization and the merits of a yet-to-be-filed chapter 11 plan,' which was 'both premature and improper.' " Debtor's Notice at 1–2 (quoting Off. Comm. of Asbestos Claimants, 71 F.4th at 183). The Committee's appeal and motion for leave to appeal the Opinion and Order remained pending before the District Court at the time the court issued its ruling from the bench on the Motions to Dismiss on July 28, 2023.⁸

6. The Committee filed a second motion to dismiss (Dkt. 938) (the "Second Motion to Dismiss") on August 16, 2019, arguing primarily that the case should be dismissed *355 based on the Debtor's failure to prosecute this case. The Committee filed the Second Motion to Dismiss less than one month after the court entered the Opinion and Order, and the

court entered an order (Dkt. 1546) on December 22, 2020 denying the Second Motion to Dismiss without prejudice. The court decided that the Debtor had not failed to prosecute the Chapter 11 case within the meaning of section 1112(b)(4) and that the Committee had not established cause to dismiss the case.

7. In the Committee's Motion (its third motion to dismiss this case), the Committee moves to dismiss this case for lack of constitutional subject matter jurisdiction. The Committee asserts that the Debtor is not an eligible subject of bankruptcy pursuant to the Bankruptcy Clause of the Constitution because it lacks sufficient financial distress. Committee's Motion at 2. According to the Committee, the Debtor is neither insolvent nor in need of bankruptcy for its survival and, therefore, does not qualify for bankruptcy relief. Id. The Committee insists that "Bestwall's economic health and ability to timely and fully pay all its creditors, including all present and future asbestos claimants, is (and was at the time of its bankruptcy filing) unthreatened. Neither financial nor operational requirements have necessitated bankruptcy restructuring, and Bestwall is therefore not an eligible 'subject of [B]ankruptc[y]' as that word was understood by the drafters of the Constitution and the delegates ratifying the Constitution." Id. The Committee contends that "a bankruptcy court must first determine whether the entity seeking debtor status meets the fundamental requirements of the Constitution" before considering statutory restrictions on debtors, including whether a bankruptcy case should be dismissed as a bad faith filing. Id. In other words, the Debtor must be in sufficient financial distress to be constitutionally eligible to seek protection under the Bankruptcy Code.

8. In support of its argument, the Committee cites findings of fact made by this court in its Opinion and Order and its July 29, 2019 Memorandum Opinion and Order Granting the Debtor's Request for Preliminary Injunctive Relief (A.P. Dkt. 164⁹) in reliance on the Debtor's assertion that it is fully capable of paying all asbestos claims in full with the support of the funding agreement. Id. at 4. The Committee further relies on developments that have occurred since the filing of the case to demonstrate that Bestwall's financial wherewithal has grown stronger as this case has progressed. Id. at 4–5. Specifically, the Committee points to the facts that since the filing of the case, Bestwall has created and funded a \$1 billion qualified settlement trust; New GP's equity value has

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increased by \$7.1 billion to \$27.8 billion; and New GP has upstreamed over \$5 billion in dividends to its ultimate parent, Koch Industries. *Id.* at 5.

9. The Committee asserts that this motion to dismiss “is a new and distinct argument from any previously raised; [and] it also provides additional context for considering the proper scope and application of the Fourth Circuit’s [Carolin](#) test,” which it concedes was the focus of the First Motion to Dismiss. *Id.* at 7, 9. According to the Committee, in addition to lacking constitutional subject matter jurisdiction, the “Fourth Circuit’s case law, regarding debtors whose bankruptcies were dismissed for bad faith, must be read, interpreted and applied within the constitutional limitations of bankruptcy jurisdiction.” *Id.* at 20. The Committee says that consistent with the constitutional requirement of significant financial *356 distress, “[t]he rationale behind [Carolin](#) ... suggests that real financial distress is, in effect, to be assumed or accepted before application of the [Carolin](#) test.” *Id.* at 26.

10. This part of the Committee’s argument is consistent with the Buckingham Motion. Mr. Buckingham argues this case must be dismissed because it does not meet the good-faith threshold established by the Fourth Circuit in [Carolin](#), the Debtor is not eligible for bankruptcy relief because it is neither in financial distress nor facing “overwhelming liabilities,” and it cannot confirm a § 524(g) plan of reorganization. Buckingham Motion at 7. The Buckingham Motion relies extensively on the Third Circuit’s recent LTL Opinion dismissing the LTL Management case as a bad faith filing in urging the court to dismiss this case under 11 U.S.C. §§ 105 and 1112(b) for lack of good faith.¹⁰ See *id.* at 3, 4, 6, 10, 12–13, 19, 20, 22–23, 26–27. Similar to the conclusion reached by the Third Circuit in the LTL Opinion, Mr. Buckingham argues that pursuant to [Carolin](#), and as a threshold matter, the Debtor must demonstrate it is in sufficient financial distress due to overwhelming asbestos liability and that it has a limited fund that is insufficient to pay current and future claimants in order for its bankruptcy case to serve a legitimate bankruptcy purpose and to survive a motion to dismiss the case as a bad faith filing. *Id.* at 8, 15. Only once the Debtor has demonstrated sufficient financial distress should the court reach the question of the Debtor’s ability to be rehabilitated. *Id.* at 8. And like the Committee’s Motion, Mr. Buckingham relies on several events that have occurred since the filing of the case that he believes demonstrate the

Debtor’s lack of financial distress and the impropriety of the case, including the fact that New GP has distributed over \$5 billion in dividends to Koch Industries and New GP’s substantial increase in equity value. *Id.* at 14–15, 17. Mr. Buckingham argues that the proper focus is not the number of asbestos claims pending against the Debtor but the Debtor’s ability to pay those claims. *Id.* at 6. And the profitability of the Debtor since this case was filed—as evidenced by the dividends issued by New GP and the substantial increase in its equity—demonstrates the Debtor’s clear ability to pay its current and future asbestos claims. *Id.* at 14–15. On this basis, Mr. Buckingham moves to have the court dismiss this case as a bad faith filing pursuant to [Carolin](#).

11. In response, the Debtor contends that the court lacks jurisdiction to consider the Buckingham Motion because it seeks the same relief that was sought by the Committee in its First Motion to Dismiss on fundamentally the same grounds. Debtor’s Response to the Buckingham Motion at 1, 17–25. The Debtor argues the court is divested of jurisdiction to consider the Buckingham Motion due to the Committee’s appeal of the court’s Opinion and Order denying the First Motion to Dismiss and its motion for leave to appeal. *Id.* at 5–8. In addition, the Debtor insists that Mr. Buckingham should be barred by the doctrine of laches from bringing his motion to dismiss given the length of time this case has been pending. The Debtor also argues that the Opinion and Order is law of the case and the court should deny the Buckingham Motion because it seeks to dismiss *357 the case on the same grounds argued by the Committee in the First Motion to Dismiss. *Id.* at 8–11. Finally, the Debtor insists that even if the court were to consider the merits of the Buckingham Motion, it presents no new arguments that would cause the court to reach a different conclusion than when it denied the First Motion to Dismiss. *Id.* at 17–25.

12. Similarly, in its response to the Committee’s Motion, the Debtor asserts that the doctrines of laches and law of the case bar the Committee’s argument and that this court is divested of jurisdiction to consider the dismissal issues raised in the Committee’s Motion because they are pending before the District Court on appeal. Debtor’s Opposition to the Official Committee of Asbestos Claimants’ Third Motion to Dismiss Chapter 11 Case (Dkt. 2973) at 2, 13–19. In response to the Committee’s assertion that this court lacks subject matter jurisdiction, the Debtor insists that the court has jurisdiction and has properly exercised it in the six years this case has

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been pending. *Id.* at 2, 6–13. According to the Debtor, the question of eligibility to be a debtor is not a question of jurisdiction because bankruptcy courts have subject matter jurisdiction over all cases filed under the Bankruptcy Code. *Id.* at 7 (quoting *In re Auto. Pros., Inc.*, 370 B.R. 161, 167 (Bankr. N.D. Ill. 2007)). Further, the Debtor argues that the Bankruptcy Clause of the United States Constitution does not impose an insolvency or financial distress requirement to be a debtor. *Id.* at 9.

Discussion

[1] 13. Mr. Buckingham seeks dismissal of this case under *Carolin* largely for the same reasons previously argued by the Committee in its First Motion to Dismiss and considered and decided by this court in its Opinion and Order. As demonstrated by the chart (“Debtor’s Chart”) attached as Exhibit A to the Debtor’s Response to the Buckingham Motion, Mr. Buckingham and the Committee use similar language to argue that the court should dismiss this case as a bad faith filing and that the Debtor and/or New GP are not in financial distress.

[2] 14. Pursuant to the law of the case doctrine and in the interest of finality, “when a court decides upon a rule of law, that decision should continue to govern the same issues in subsequent stages in the same case.” *Carlson v. Bos. Sci. Corp.*, 856 F.3d 320, 325 (4th Cir. 2017) (quoting *TFWS, Inc. v. Franchot*, 572 F.3d 186, 191 (4th Cir. 2009)); see also *Mar-Bow Value Partners, LLC v. McKinsey Recovery & Transformation Servs. U.S., LLC*, 469 F. Supp. 3d 505, 524 (E.D. Va. 2020) (“[C]learly, courts could not perform their duties satisfactorily and efficiently if a question once considered and decided were to be litigated anew in the same case” (quoting *Sejman v. Warner-Lambert Co.*, 845 F.2d 66, 68–69 (4th Cir. 1988))).

[3] 15. To determine the extent to which the law of the case governs, the court must first determine what issues it decided in the Opinion and Order and then decide whether any exceptions apply that might justify departing from the law of the case. See *Mar-Bow*, 469 F. Supp. 3d at 525. “The Fourth Circuit has recognized three exceptions to the law of the case doctrine: ‘(1) a subsequent trial produces substantially different evidence, (2) controlling authority has since made

a contrary decision of law applicable to the issue, or (3) the prior decision was clearly erroneous and would work manifest injustice.’ ” *Id.* (quoting *TFWS*, 572 F.3d at 191). In addition, “the Supreme Court has advised that a ‘court has the power to revisit prior decisions of its own or of a coordinate court in any circumstance, although as a rule courts should be loathe to do so in the *358 absence of extraordinary circumstances’ ” *Id.* (quoting *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 817, 108 S.Ct. 2166, 100 L.Ed.2d 811 (1988)).

16. As previously explained, the court concluded under *Carolin* in its Opinion and Order that this case is not objectively futile because Bestwall has the resources with which to reorganize, and, therefore, the court did not need to reach the issue of whether the case was filed in subjective bad faith and declined to dismiss this case under the Fourth Circuit’s two-prong dismissal standard. *Bestwall*, 605 B.R. at 49–51. In reaching that conclusion, the court found that attempting to resolve asbestos claims through section 524(g) is a valid reorganizational purpose and that the volume of current asbestos claims coupled with the number of claims to be filed is sufficient financial distress for the Debtor to file this Chapter 11 case. *Id.* at 49.

17. In considering the exceptions to the law of the case doctrine, the court notes that Mr. Buckingham does not cite to substantially different evidence (or any evidence produced in a subsequent trial) sufficient to cause this court to revisit the Opinion and Order. Rather, he relies on the comments of Bestwall’s counsel at a meeting of the American Bankruptcy Institute, Buckingham Motion at 4, 5, 17, 20, 21, that largely appear to have been taken out of context and are not inconsistent (when read in context) with statements Debtor’s counsel has made on the record to this court. Mr. Buckingham focuses on the dividends issued by Georgia-Pacific post-petition, *id.* at 5, 6, 14–15, 16–17, 27, that have been disclosed throughout this case and are consistent with corporate practice predating this case, see Stipulation Regarding Postpetition Dividends Paid by Non-Debtor Georgia-Pacific LLC (Dkt. 997); Declaration of Tyler L. Woolson (Dkt. 998); Second Stipulation Regarding Postpetition Dividends Paid by Non-Debtor Georgia-Pacific LLC (Dkt. 2346); Declaration of Tyler L. Woolson (Dkt. 2347); Declaration of Julie A. Anderson (Dkt. 2857). Additionally, the Debtor’s rejection of the Committee’s plan does not serve as a basis for this court to reconsider the Opinion and Order. At a prior hearing in this case, the court noted that the Committee’s plan is “akin to

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dismissal” and would need to be modified to be confirmable.
See Oct. 22, 2020 Hr’g Tr. 16:22–24; 17:22–23.

[4] 18. Mr. Buckingham points to the Fourth Circuit’s recently-issued opinion in the [Kaiser](#) case as new law issued by controlling authority that is applicable to the issue of whether the court should dismiss this case under [Carolin](#). Buckingham Motion at 2, 6, 11 (citing [In re Kaiser Gypsum Co.](#), 60 F.4th 73 (4th Cir. 2023)). According to Mr. Buckingham, in [Kaiser](#) “the Fourth Circuit Court of Appeals reiterated the purpose of Chapter 11 generally and of [Section 524\(g\)](#) specifically: it is for (a) financially distressed debtors, (b) faced with overwhelming asbestos liabilities, to (c) create a trust that marshals limited and inadequate assets so that present and future claimants share equitably—providing all with a better outcome than a forced liquidation.” Buckingham Motion at 2 (emphasis omitted) (citing [Kaiser](#), 60 F.4th at 77–78). Mr. Buckingham, however, misconstrues the discussion of [section 524\(g\)](#), which is in two introductory paragraphs of an opinion that addresses an insurer’s standing to object to a Chapter 11 plan. Financial distress was not at issue in [Kaiser](#), and the cited portion of [Kaiser](#) actually confirms that “§ 524(g) of the Bankruptcy Code allows a Chapter 11 debtor with **substantial asbestos liabilities** to obtain a channeling injunction that diverts all asbestos claims, current and future, to a trust established by the debtor’s reorganization *359 plan and funded by the debtor,” [Kaiser](#), 60 F.4th at 77–78 (emphasis added), which is not inconsistent with the conclusion reached by this court in its Opinion and Order.

19. Mr. Buckingham also relies heavily on the Third Circuit’s recent LTL Opinion as mandating the dismissal of this case. See *supra* ¶ 10. That opinion, however, is neither controlling nor applicable to this matter. Indeed, the Third Circuit recognizes in the LTL Opinion that “[i]n 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.’” [LTL](#), 64 F.4th at 98 n.8 (quoting [Carolin](#), 886 F.2d at 694). The Third Circuit also acknowledges the reference by the bankruptcy court below to the Fourth Circuit’s dismissal standard as a “much more stringent standard for dismissal of a case for lacking good faith” than the standard in the Third Circuit, but it did not analyze—nor should it have—whether this case should be dismissed pursuant to that standard. [Id.](#) (quoting [In re LTL Mgmt., LLC](#), 637 B.R. 396, 406 (Bankr. D.N.J. 2022)).

20. In sum, the Buckingham Motion seeks to have this court reconsider its earlier ruling in the Opinion and Order. Counsel for Mr. Buckingham insists to the contrary and at the hearing on the Buckingham Motion, he argued that the First Motion to Dismiss “was a different focus at a different time on different facts by a different party.” March 15, 2023 Hr’g Tr. 19:12–13. While the movant is different and the motion was filed four and a half years after the First Motion to Dismiss, the focus is on substantially the same facts, some new facts that the court does not consider to be substantially different evidence, and some new law that is either not controlling or is consistent with the court’s Opinion and Order. And the ultimate question remains exactly the same: should the court dismiss this case as a bad faith filing under [Carolin](#)? Neither the new facts cited by Mr. Buckingham nor the new law issued since the court entered its Opinion and Order cause this court to conclude that its earlier decision to deny the First Motion to Dismiss was either erroneous or works a manifest injustice, extraordinary circumstances do not exist which cause this court to revisit its earlier decision, and the court concludes that the Opinion and Order continues to be the law of this case.

[5] [6] [7] 21. In addition to concluding that the Opinion and Order is the law of this case and should not be reconsidered, the court also thinks that its jurisdiction to do so is questionable given the pending appeal of the Opinion and Order. Generally, the timely filing of a notice of appeal “confers jurisdiction on the court of appeals and divests the district court¹¹ of its control over those aspects of the case involved in the appeal.” [Levin v. Alms & Assocs., Inc.](#), 634 F.3d 260, 263 (4th Cir. 2011) (quoting [Griggs v. Provident Consumer Disc. Co.](#), 459 U.S. 56, 58, 103 S.Ct. 400, 74 L.Ed.2d 225 (1982)). For the same reasons, “[a] bankruptcy court is divested of jurisdiction with respect to matters raised in an appeal to a higher court.” [In re Bryant](#), 175 B.R. 9, 13 (W.D. Va. 1994) (citing [In re Bialac](#), 694 F.2d 625, 627 (9th Cir. 1982)). *360 “The purpose of the general rule is to avoid the confusion of placing the same matter before two courts at the same time and [to] preserve the integrity of the appeal process.” [In re Whispering Pines Ests., Inc.](#), 369 B.R. 752, 757 (B.A.P. 1st Cir. 2007) (citations omitted); see also [Doe v. Pub. Citizen](#), 749 F.3d 246, 258 (4th Cir. 2014) (The divesting rule “fosters judicial economy and guards against the confusion and inefficiency that would result if two courts simultaneously were considering the same issues.”).

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[8] [9] 22. The court is attuned to the fact that bankruptcy cases often raise multiple issues, many of which are entirely unrelated to issues involved in an appeal. For that reason, “[t]he application of a broad rule that a bankruptcy court may not consider any request filed while an appeal is pending has the potential to severely hamper a bankruptcy court’s ability to administer its cases in a timely manner.” [Whispering Pines](#), 369 B.R. at 758 (citations omitted). And courts recognize that “when a notice of appeal has been filed in a bankruptcy case, the bankruptcy court retains jurisdiction to address elements of the bankruptcy proceeding that are not the subject of that appeal.” [In re Scopac](#), 624 F.3d 274, 280 (5th Cir. 2010) (quoting [In re Transtexas Gas Corp.](#), 303 F.3d 571, 580 (5th Cir. 2002)). The end result is a functional test: “once an appeal is pending, it is imperative that a lower court not exercise jurisdiction over those issues which, although not themselves expressly on appeal, nevertheless so impact the appeal so as to interfere with or effectively circumvent the appeal process.” [Id.](#) (quoting [Whispering Pines](#), 369 B.R. at 759).

23. That is the situation here given the similarity between the issues raised in the Buckingham Motion and those on appeal in the District Court. For this court to exercise jurisdiction over the issues raised in the Buckingham Motion could unnecessarily interfere with or confuse the appeal process. For the same reasons previously explained, the Buckingham Motion is an attempt to have the court reconsider its Opinion and Order, and the issues raised in the motion are closely related to the issues on appeal in the District Court. The Buckingham Motion seeks dismissal of this case for “cause” under [section 1112\(b\)](#) as a bad faith filing for many of the same reasons previously argued by the Committee in its First Motion to Dismiss and considered and decided by this court in its Opinion and Order denying that motion. *See* Debtor’s Chart (comparing arguments from the First Motion to Dismiss and the Buckingham Motion). Mr. Buckingham asks this court to bring “fresh eyes” and “hindsight” to its prior ruling and disputes the Debtor’s earlier arguments against dismissal. Buckingham Motion at 4–5. By way of further example, the Buckingham Motion cites the LTL Opinion in arguing that financial distress is a threshold requirement when considering a debtor’s good faith in seeking the benefits of a bankruptcy filing. *See supra* ¶ 10. Similarly, the Committee filed a notice of supplemental authority to bring the LTL Opinion to the attention of the District Court and relies on it as a basis for the District Court to accept the appeal of the Opinion and

Order so the Fourth Circuit can consider “the applicability of the [Carolin](#) standard [to] a debtor that failed to exhibit financial distress prior to invoking the substantial protections of the Bankruptcy Code.” Committee’s Notice at 2. Both the Committee and Mr. Buckingham argue that this case lacks a valid bankruptcy purpose, manipulates the Bankruptcy Code and bankruptcy jurisdiction, and deprives victims of jury trial rights. *See, e.g.*, First Motion to Dismiss at 15–18, Committee’s reply in support of First Motion to Dismiss (Dkt. 653) *361 at 13, Buckingham Motion at 4, 7. Finally, the crux of both motions is a determination of whether this case should be dismissed under [Carolin](#) as a bad faith filing. In short, the issues raised in the Buckingham Motion are closely related to the matter on appeal and consideration of the merits of the Buckingham Motion could “so impact the appeal ... as to interfere with or effectively circumvent the appeal process.” [Scopac](#), 624 F.3d at 280 (quoting [Whispering Pines](#), 369 B.R. at 759).

[10] 24. There is an exception to the divestment rule if the appeal is interlocutory. *See BAE Sys. Tech. Sol. & Servs., Inc. v. Republic of Korea*, No. 14-3551, 2016 WL 6167914, at *3 (D. Md. Oct. 24, 2016) (“Interlocutory appeals do not divest [lower] courts of jurisdiction.” (citing [Columbus-Am. Discovery Grp. v. Atl. Mut. Ins. Co.](#), 203 F.3d 291, 302 (4th Cir. 2000))). The determination of whether the Opinion and Order is interlocutory, however, is also pending in the District Court. As [Bryant](#) recognized, “it is not for this court to determine ultimately whether its order is properly appealable such that jurisdiction has vested in the appellate court.” 175 B.R. at 12–13. To rule on that issue and to reconsider the court’s earlier ruling on the First Motion to Dismiss while the appeal remains pending could moot the appeal, lead to inconsistent results, or prompt a second appeal. Undoubtedly, it would unnecessarily muddy the waters. For those reasons, the court will decline to consider the merits of the issues raised in the Buckingham Motion. ¹²

[11] 25. With respect to the arguments the Committee makes regarding [Carolin](#) by extension of its subject matter jurisdiction argument, the court will decline to reconsider its earlier rulings in the Opinion and Order for the same reasons it is declining to consider the Buckingham Motion on the merits. Issues of subject matter jurisdiction, however, “may be resurrected at any point in the litigation.” [Gonzalez v. Thaler](#), 565 U.S. 134, 141, 132 S.Ct. 641, 181 L.Ed.2d 619 (2012);

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see also [Ashcroft v. Iqbal](#), 556 U.S. 662, 671, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (“Subject-matter jurisdiction cannot be forfeited or waived and should be considered when fairly in doubt.” (citing [Arbaugh v. Y & H Corp.](#), 546 U.S. 500, 514, 126 S.Ct. 1235, 163 L.Ed.2d 1097 (2006))); [Educ. Credit Mgmt. Corp. v. Kirkland \(In re Kirkland\)](#), 600 F.3d 310, 315 (4th Cir. 2010) (“[S]ubject matter jurisdiction may be questioned at any stage of litigation, including an appeal.”); [In re Aldrich Pump LLC](#), Ch. 11 Case No. 20-30608, 2023 WL 9016506, at *9 (Bankr. W.D.N.C. Dec. 28, 2023) (“Lack of subject matter jurisdiction can be asserted at any time.” (citations omitted)). Because the absence of subject matter jurisdiction may be raised at any time, the court will consider that aspect of the Committee’s Motion.

*362 [12] [13] [14] [15] [16] 26. This court and all federal courts have limited jurisdiction and can only exercise the power authorized by the Constitution and Congress. [Kokkonen v. Guardian Life Ins. Co. of Am.](#), 511 U.S. 375, 377, 114 S.Ct. 1673, 128 L.Ed.2d 391 (1994); [Owen Equip. & Erection Co. v. Kroger](#), 437 U.S. 365, 374, 98 S.Ct. 2396, 57 L.Ed.2d 274 (1978). Subject matter jurisdiction sets the outer limit of a court’s authority, and nonjurisdictional rules control within the jurisdictional boundaries. [Santos-Zacaria v. Garland](#), 598 U.S. 411, 416, 143 S.Ct. 1103, 215 L.Ed.2d 375 (2023) (citations omitted). The Bankruptcy Clause of the Constitution determines the limits of constitutional subject matter jurisdiction for bankruptcy. See [Wright v. Union Cent. Life Ins. Co.](#), 304 U.S. 502, 513, 58 S.Ct. 1025, 82 L.Ed. 1490 (1938) (providing that the right of Congress to legislate on bankruptcy is in general terms and quoting the Bankruptcy Clause); [Schumacher v. Beeler](#), 293 U.S. 367, 374, 55 S.Ct. 230, 79 L.Ed. 433 (1934) (“The Congress, by virtue of its constitutional authority over bankruptcies (Const. Art. 1, § 8), could confer or withhold jurisdiction to entertain such suits and could prescribe the conditions upon which the federal courts should have jurisdiction.”); Ralph Brubaker, *On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory*, 41 WM. & MARY L. REV. 743, 807 (2000) [hereinafter *Federal Bankruptcy Jurisdiction*] (noting that most Supreme Court discussions of bankruptcy jurisdiction rely on the Bankruptcy Clause); William E. Mussman & Stefan A. Riesenfeld, *Jurisdiction in Bankruptcy*, 13 LAW & CONTEMP. PROBS. 88, 89 (1948) (reading the scope of the Bankruptcy Clause with Article III as allowing all bankruptcy jurisdiction in federal court). But see [Aldrich](#), 2023 WL 9016506, at *13 (“[C]onstitutional

challenges which are not targeted at the scope of Article III are not challenges to the Court’s subject matter jurisdiction.”).¹³ Congress determines subject matter jurisdiction within any limitations imposed by the Constitution. [United States v. Denedo](#), 556 U.S. 904, 912, 129 S.Ct. 2213, 173 L.Ed.2d 1235 (2009). The party advocating in favor of a court’s subject matter jurisdiction over a particular case or issue bears the burden of proof. [Demetres v. E. W. Constr., Inc.](#), 776 F.3d 271, 272 (4th Cir. 2015); [Piney Run Pres. Ass’n v. Cnty. Comm’rs](#), 523 F.3d 453, 459 (4th Cir. 2008); [Glaspell v. United States \(In re Glaspell\)](#), Ch. 7 Case No. 17-bk-00301, Adv. No. 19-ap-36, 2020 WL 4577479, at *2 (Bankr. N.D. W. Va. Aug. 7, 2020).

[17] [18] [19] 27. Since subject matter jurisdiction can be raised at any time and is a requirement for courts to exercise their power, it cannot be defeated by equitable defenses. See [Gonzalez](#), 565 U.S. at 141, 132 S.Ct. 641 (“Subject-matter jurisdiction can never be waived or forfeited.”); cf. [Valley Historic Ltd. P’ship v. Bank of N.Y.](#), 486 F.3d 831, 838 (4th Cir. 2007) (deciding even res judicata does not overcome a bankruptcy court’s obligation to determine its subject matter jurisdiction). The concepts of consent, waiver, and estoppel do not apply to subject matter jurisdiction because it is created and limited by the Constitution and statutes. [Constantine v. Rectors & Visitors of George Mason Univ.](#), 411 F.3d 474, 480 (4th Cir. 2005); see [MOAC Mall Holdings LLC v. Transform Holdco LLC](#), 598 U.S. 288, 298, 143 S.Ct. 927, 215 L.Ed.2d 262 (2023) (“[N]ot even such egregious conduct by a litigant could permit the application of judicial estoppel as against a jurisdictional rule.”). Similarly, neither laches nor the law of the *363 case doctrine¹⁴ prevents review of subject matter jurisdiction. [Hager v. Gibson](#), 188 B.R. 194, 196 (E.D. Va. 1995) (laches); [Aldrich](#), 2023 WL 9016506, at *9 (laches); [Am. Canoe Ass’n, Inc. v. Murphy Farms, Inc.](#), 326 F.3d 505, 515–16 (4th Cir. 2003) (law of the case).

[20] 28. Since the equitable defenses proffered by the Debtor are insufficient to defeat a motion challenging subject matter jurisdiction, the court will consider the Committee’s Motion on the merits. The Committee’s nuanced argument is that the court does not have constitutional subject matter jurisdiction to hear this case due to the Debtor’s lack of financial distress.¹⁵ See *supra* ¶ 7. Put another way, the Committee contends that the language of the Bankruptcy Clause implicitly disqualifies entities that are not suffering financial

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distress from invoking the subject matter jurisdiction of this court. Since there is no subject matter jurisdiction, according to the Committee, this case is void and must be dismissed.

29. Accordingly, the court must look to the language of the Bankruptcy Clause and its meaning in order to determine whether there is subject matter jurisdiction for this case. The Bankruptcy Clause is found at [Article I, Section 8, Clause 4 of the Constitution](#) and provides, in its entirety, that “Congress shall have Power ... To establish ... uniform Laws on the subject of Bankruptcies throughout the United States.” The limited constitutional guidance on the breadth of the bankruptcy power does not explicitly require debtors to suffer from any level of financial distress. In fact, the Bankruptcy Clause does not provide any guidance at all about what types of entities are constitutionally eligible for bankruptcy protection. The Committee, however, contends that the Debtor exceeds the constitutional grant of jurisdiction because it is not a proper “subject of Bankruptcies” due to its lack of financial distress. *See* Committee’s Motion at 2. In other words, according to the Committee, Congress could not make any “uniform Laws on the subject of Bankruptcies” applicable to this Debtor. In a way, and contrary to more typical challenges to subject matter jurisdiction, the Committee is not challenging a law about subject matter jurisdiction but the absence thereof, contending ^{*364} that Congress failed to include a necessary condition, financial distress, in its statutory grant of jurisdiction to the bankruptcy court.

30. Since the language of the Bankruptcy Clause does not address the meaning of “the subject of Bankruptcies,” the court looks to the meaning of the clause at the time of adoption and as interpreted by courts since then. Bankruptcy and insolvency law ¹⁶ as practiced in 1787 in England and the United States (pre-Constitution) undoubtably influenced the Framers of the Bankruptcy Clause. *See Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 362, 126 S.Ct. 990, 163 L.Ed.2d 945 (2006) (“It is appropriate to presume that the Framers of the Constitution were familiar with the contemporary legal context when they adopted the Bankruptcy Clause”). English law bore some similarities with modern bankruptcy law, but the modern bankruptcy practitioner would probably be more struck by the differences. *See* Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 499–503 (1996) [hereinafter “*Constitutional Limits*”]

(discussing similarities and differences). Eighteenth-century English bankruptcy was exclusively for the benefit of creditors, and the system was strictly involuntary. *Cont’l Ill. Nat’l Bank & Tr. Co. of Chi. v. Chi., Rock Island & Pac. Ry. Co.*, 294 U.S. 648, 668, 55 S.Ct. 595, 79 L.Ed. 1110 (1935). But *see Constitutional Limits*, *supra*, at 496 n.33 & 510 (arguing that English bankruptcy was only technically limited to involuntary petitions because friendly creditors frequently commenced cases). The concept of the discharge of debts was not introduced until 1705 (along with the death penalty for fraudulent debtors), and Parliament conditioned discharge on the consent of 80% of the creditor body (in number and amount of debt) the following year. *Constitutional Limits*, *supra*, at 500, 505–06. In addition, only businessmen (“traders”) could be debtors in England at the time. ¹⁷ *Hanover Nat’l Bank of the City of N.Y. v. Moyses*, 186 U.S. 181, 184–85, 22 S.Ct. 857, 46 L.Ed. 1113 (1902). Despite these fundamental differences, some aspects of 18th century English bankruptcy law, such as the use of the predecessors of trustees, meetings of creditors, and proofs of claims, would be recognizable to a modern bankruptcy practitioner. *Constitutional Limits*, *supra*, at 500–01. Perhaps most importantly for this court’s present purposes, 18th century English bankruptcy law did not require insolvency. ¹⁸ ^{*365} *In re Klein*, 14 F. Cas. 716, 717 (C.C.D. Mo. 1843) (“By the English law, ... it mattered not whether the defendant was insolvent or otherwise”); Thomas E. Plank, *Bankruptcy and Federalism*, 71 FORDHAM L. REV. 1063, 1094 (2002) [hereinafter *Bankruptcy and Federalism*] (noting that insolvency was not always required by 18th century laws). But *see Bankruptcy and Federalism*, *supra*, at 1094 (arguing that “acts of bankruptcy” and other jurisdictional requirements represented “more particular examples of insolvency”).

31. Some American colonies and states got an early start on federalism, embraced the idea of the states as the laboratories of democracy, *see New State Ice Co. v. Liebmann*, 285 U.S. 262, 311, 52 S.Ct. 371, 76 L.Ed. 747 (1932) (“It is one of the happy incidents of the federal system that a single courageous state may, if its citizens chose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.”), and experimented more with their bankruptcy systems. *Bankruptcy and Federalism*, *supra*, at 1085. Unlike English law, certain jurisdictions allowed

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voluntary proceedings, non-consensual discharge of debts, and non-trader debtors. [Klein](#), 14 F. Cas. at 717; *Bankruptcy and Federalism*, *supra*, at 1085–87.

32. Against this backdrop, the Framers of the Constitution met in Philadelphia and adopted, among other provisions, the Bankruptcy Clause. Unfortunately for courts trying to divine its meaning 250 years later, the Framers did not give us much with which to work. See *Constitutional Limits*, *supra*, at 527 (noting that “[t]he proceedings of the Constitutional Convention shed little light” on the intent of the Bankruptcy Clause). The only vote against the Bankruptcy Clause came from a member of the Connecticut delegation who feared giving Congress the power to institute the death penalty as a punishment for bankruptcy. [Katz](#), 546 U.S. at 369, 126 S.Ct. 990 (citation omitted); [Ry. Lab. Execs.’ Ass’n v. Gibbons](#), 455 U.S. 457, 472 & n.13, 102 S.Ct. 1169, 71 L.Ed.2d 335 (1982) (citation omitted). In the only meaningful, if brief, discussion of bankruptcy in *The Federalist*, James Madison emphasized the close relationship between bankruptcy and commerce as proof of the importance of uniform bankruptcy laws. [Gibbons](#), 455 U.S. at 465–66, 102 S.Ct. 1169 (“As James Madison observed, ‘[t]he power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the 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.’” (alteration in original) (quoting THE FEDERALIST No. 42 at 285 (N.Y. Heritage Press 1945))). There is no direct evidence about whether the Framers intended to enshrine English bankruptcy law into the Constitution or had a more general concept of bankruptcy in mind. *Constitutional Limits*, *supra*, at 527. Likewise, there is no direct evidence that the Framers intended to require financial distress for bankruptcy jurisdiction.

33. It is difficult to discern exactly what the Framers had in mind for bankruptcy law, and subsequent developments (and the Supreme Court opinions allowing them) suggest that the Framers’ intent was not of utmost importance, as the Framers could not have foreseen the ways that American bankruptcy would change (and be allowed to change). The liberalization of bankruptcy law, however, did not start immediately. The first several Congresses attempted but failed to pass a *366 bankruptcy law until the first bankruptcy act passed in 1800. [Katz](#), 546 U.S. at 373, 126 S.Ct. 990 (quoting C. WARREN, BANKRUPTCY IN

UNITED STATES HISTORY 10 (1935)). The 1800 law was a copy of the familiar English law. [Id.](#); *Constitutional Limits*, *supra*, at 499 & 533. But see [Cont’l Ill.](#), 294 U.S. at 670, 55 S.Ct. 595 (claiming the first American bankruptcy law “ignored” English law by expanding the reach beyond traders).¹⁹

34. More fundamental changes to the American bankruptcy system followed. The 1841 Act took a “radical step forward” by introducing voluntary petitions. [Cont’l Ill.](#), 294 U.S. at 670, 55 S.Ct. 595; see also [In re Marshall](#), 300 B.R. 507, 516, 520 (Bankr. C.D. Cal. 2003) (noting that the 1841 Act was the first American bankruptcy law that allowed voluntary petitions), *aff’d*, 403 B.R. 668 (C.D. Cal. 2009), *aff’d*, 721 F.3d 1032 (9th Cir. 2013).²⁰ Previous bankruptcy regimes were intended to benefit creditors and viewed debtors as dishonest, but the 1841 law began the assumption of the honest but unfortunate debtor. [Cont’l Ill.](#), 294 U.S. at 670–71, 55 S.Ct. 595 (quoting [Loc. Loan Co. v. Hunt](#), 292 U.S. 234, 244, 54 S.Ct. 695, 78 L.Ed. 1230 (1934)). Justice Catron, sitting as a circuit judge, reversed a district court ruling that the Bankruptcy Clause only allowed the 1787 English version of bankruptcy. [Klein](#), 14 F. Cas. at 716, 719.

35. Insolvency was never a requirement for English or early American involuntary cases, which instead required “acts of bankruptcy.” [Marshall](#), 300 B.R. at 517–18. The 1841 Act did include a requirement for voluntary debtors to plead an inability to pay their debts, but it “was only a pleading requirement” as “[n]either the parties nor the court had the authority to inquire into whether a debtor was in fact insolvent.” [Id.](#) at 516 (citing [Ex parte Hull](#), 12 F. Cas. 853, 856 (S.D.N.Y. 1842)). This insolvency pleading requirement carried over into the 1867 Act but “disappeared entirely in 1878 (the date of repeal of the 1867 Act)” and did not reappear for voluntary cases in subsequent bankruptcy laws. [Id.](#) at 517.

36. The 1867 Act also continued the expansion of (or at least change in) American bankruptcy law from its English roots. A creditor challenged a provision of the 1867 Act allowing discharge on the partial payment of debt as not part of “the subject of Bankruptcies” as intended by the Bankruptcy Clause. [In re Reiman](#), 20 F. Cas. 490, 492–93 (S.D.N.Y. 1874). A future Supreme Court justice, then-Judge Blatchford, catalogued the differences between bankruptcy as practiced in England and the United States and held that

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“[i]t cannot be doubted, that [C]ongress, in passing laws on the subject of bankruptcies, is not restricted to laws with such scope only as the English bankruptcy laws had when the [C]onstitution was adopted.” *Id.* at 495–96; see also *Constitutional Limits*, *supra*, at 539–40 (summarizing [Reiman](#) and noting Judge Blatchford's subsequent Supreme Court position).

37. Congress enacted the first permanent American bankruptcy law in 1898. *Constitutional Limits*, *supra*, at 540. Among other innovations, the 1898 Act removed the need for creditors to consent to the debtor's discharge. *Id.* The Supreme Court faced a creditor's complaint that the 1898 Act violated the Bankruptcy Clause due to a lack of uniformity, the delegation of legislative power to the states, allowing *367 non-trader debtors, and permitting voluntary petitions. [Moyses](#), 186 U.S. at 183–84, 22 S.Ct. 857. The new law, however, “easily withstood challenges to its constitutionality as within the ‘subject of Bankruptcies.’ ” *Constitutional Limits*, *supra*, at 540–41 (citing [Moyses](#), 186 U.S. at 187, 22 S.Ct. 857).

38. Congress further expanded the 1898 Act in 1933 by adding reorganization provisions for individuals, farmers, and railroads. *Id.* at 541. Both the Supreme Court and the Fourth Circuit endorsed the expansion. See [Cont'l Ill.](#), 294 U.S. at 671, 55 S.Ct. 595 (“[T]hese acts, far-reaching though they be, have not gone beyond the limit of congressional power; but rather have constituted extensions into a field whose boundaries may not yet be fully revealed.”); [Campbell v. Alleghany Corp.](#), 75 F.2d 947, 951 (4th Cir. 1935) (“[W]e entertain no doubt as to the constitutionality of the statute.”). The Supreme Court concluded that the “fundamental and radically progressive ... extensions” were within Congress's bankruptcy power and showed the ability of the Bankruptcy Clause to address changes in business and social interactions, [Cont'l Ill.](#), 294 U.S. at 671, 55 S.Ct. 595, while the Fourth Circuit noted that Congress was addressing the shortfalls of prior bankruptcy laws, [Campbell](#), 75 F.2d at 951.

39. Congress overhauled the 1898 Act by adopting our current bankruptcy law, the Bankruptcy Code, in 1978. Frank R. Kennedy, *The Commencement of a Case Under the New Bankruptcy Code*, 36 WASH. & LEE L. REV. 977, 981 (1979). Congress sought the recommendations of a Commission on Bankruptcy Laws of the United States, *id.* at 977–78, and, among other things, the Commission

recognized the potential for a delay in filing a bankruptcy case to doom a reorganization before it even started and sought to remove barriers to voluntary petitions, REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, pt. 1, at 75 (1973) [hereinafter “REPORT”]. Accordingly, the Code provides for a “liberalization of access” by making the “order for relief”²¹ “equivalent to adjudication under the Bankruptcy Act and ... tantamount to an order approving the court's exercise of jurisdiction” and requiring “[n]either insolvency nor inability to pay debts nor even the fact that the debtor is indebted in any amount ... to be alleged or proved” in voluntary petitions. Kennedy, *supra*, at 983–84 (footnote omitted); see also *Constitutional Limits*, *supra*, at 496 (noting that, other than a few exceptions, “there is no requirement of insolvency in any sense” to commence voluntary cases under the Bankruptcy Code).

40. This brief overview of the history of American bankruptcy law shows great change and innovation since the adoption of the Bankruptcy Clause, and the Supreme Court has described the clause in terms that suggest Congress has nearly unlimited power to determine the proper “subject of Bankruptcies.” The Court has repeatedly emphasized that the “subject of Bankruptcies” is not limited to the English and/or early state version of bankruptcy in 1787. [Wright](#), 304 U.S. at 513, 58 S.Ct. 1025 (citing [Adair v. Bank of Am. Nat'l Tr. & Sav. Ass'n](#), 303 U.S. 350, 354, 58 S.Ct. 594, 82 L.Ed. 889 (1938); [Cont'l Ill.](#), 294 U.S. at 668, 55 S.Ct. 595); [Cont'l Ill.](#), 294 U.S. at 668, 55 S.Ct. 595 (remarking that the idea that the Framers intended to limit Congress to English law had been long-dispelled (in 1935)); *368 [Moyses](#), 186 U.S. at 187, 22 S.Ct. 857 (observing that the Framers were aware of Blackstone²² and English law but granted power over the entire subject of bankruptcies without limitation); see also [Bradford v. Fahey](#), 76 F.2d 628, 632 (4th Cir. 1935) (“It is clear that the power of Congress over bankruptcies is not limited by the terms of the British and colonial statutes as they existed at the time of the adoption of the Constitution.”).

41. If the language of the Bankruptcy Clause does not require bankruptcy as practiced in 1787, what exactly does it mean? The Supreme Court has resisted giving us a precise definition and has even asserted, as recently as 2022, that the scope of the Bankruptcy Clause cannot be fully defined. [Siegel v. Fitzgerald](#), 596 U.S. 464, 473, 142 S.Ct. 1770, 213 L.Ed.2d

39 (2022) (“[T]he ‘subject of bankruptcies is incapable of final definition’ ” (quoting [Wright](#), 304 U.S. at 513, 58 S.Ct. 1025)); see also [Moyses](#), 186 U.S. at 186, 22 S.Ct. 857 (“In considering the question before me, I have not pretended to give a definition (but purposely avoided any attempt to define) the mere word ‘bankruptcy.’ ” (quoting [Klein](#), 14 F. Cas. at 718)); *Federal Bankruptcy Jurisdiction*, *supra*, at 747 (“[B]ankruptcy has become the seemingly inscrutable crucible of federal jurisdiction theory.”). Similarly, the Supreme Court has said there are some limits to Congress’s power pursuant to the Bankruptcy Clause, but the limits are also beyond definition. [Cont’l Ill.](#), 294 U.S. at 669–70, 55 S.Ct. 595 (“Those limitations have never been explicitly defined, and any attempt to do so now would result in little more than a paraphrase of the language of the Constitution without advancing far toward its full meaning.”). Given its inability to define the contours of the bankruptcy power, it is not surprising that the Court treats bankruptcy jurisdiction as unusual and unique. See, e.g., [Allen v. Cooper](#), 589 U.S. 248, 140 S. Ct. 994, 1002, 206 L.Ed.2d 291 (2020) (noting that [Katz](#) reflects “what might be called bankruptcy exceptionalism” and distinguishing [Katz](#) based on the “‘singular nature’ of bankruptcy jurisdiction” (quoting [Katz](#), 546 U.S. at 369 n.9, 126 S.Ct. 990)).

42. The Supreme Court has, however, attempted to describe elements of the undefinable bankruptcy power. For example, the “Court has repeatedly emphasized that the Bankruptcy Clause’s language, embracing ‘laws on the subject of Bankruptcies,’ is broad.” [Siegel](#), 596 U.S. at 473, 142 S.Ct. 1770; see also Charles J. Tabb, *The Bankruptcy Clause, the Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy*, 2015 No. 2 UNIV. ILL. L. REV. 765, 766 (“[T]he scope of congressional power ... is exceedingly broad.”), 778 (“Justice Catron’s *extraordinarily broad* definition of the scope of congressional power under the Bankruptcy Clause [in [Klein](#)] has been quoted in numerous cases with approval by the Supreme Court” (emphasis added)). In fact, the scope is so broad that it includes concepts that do not fit neatly into any possible definition. See, e.g., [Wright](#), 304 U.S. at 514, 58 S.Ct. 1025 (observing that the purchase of a debtor’s property by a third party is not part of the debtor-creditor relationship but “does enter into the radius of the bankruptcy power over debts”); *369 *Bankruptcy and Federalism*, *supra*, at 1100–1104 (describing a few sections of the Bankruptcy Code, including 11 U.S.C. § 363(h), that violate “the Non-Expropriation

Principle” by subordinating the property interests of third parties to the interests of creditors).

43. Congress’s bankruptcy power is not just broad; it is also potent. Courts and commentators are especially fond of describing the power as “plenary”²³ and use similar terms that suggest that Congress’s power in this field approaches omnipotence. [Siegel](#), 596 U.S. at 474, 142 S.Ct. 1770 (“plenary” (quoting [Moyses](#), 186 U.S. at 187, 22 S.Ct. 857)); [Int’l Shoe Co. v. Pinkus](#), 278 U.S. 261, 265, 49 S.Ct. 108, 73 L.Ed. 318 (1929) (“unrestricted and paramount”); [Campbell](#), 75 F.2d at 955 (“plenary”); [Reiman](#), 20 F. Cas. at 496 (“general, unlimited and unrestricted”); Ralph Brubaker, *Explaining Katz’s New Bankruptcy Exception to State Sovereign Immunity: The Bankruptcy Power as a Federal Forum Power*, 15 ABI L. REV. 95, 131 (2007) (“practically unlimited”); *Federal Bankruptcy Jurisdiction*, *supra*, at 746 (“Congress, of course, has plenary legislative power ‘on the subject of Bankruptcies.’ ”). In [In re Klein](#), Justice Catron describes a “general and unlimited” power that “gives the unrestricted authority to [C]ongress over the entire subject, as the parliament of Great Britain had it, and as the sovereign states of this Union had it before the time when the [C]onstitution was adopted.”²⁴ 14 F. Cas. at 717, 42 U.S. 277.

44. When courts do discuss the boundary of the bankruptcy power, it is usually in reference to the uniformity requirement mentioned in the Bankruptcy Clause, and uniformity is frequently referenced as the singular restriction. See [Siegel](#), 596 U.S. at 476, 142 S.Ct. 1770 (“Although the Bankruptcy Clause confers broad authority on Congress, the Clause also imposes a limitation on that authority: the requirement that the laws enacted be ‘uniform.’ ” (emphasis added)); [Gibbons](#), 455 U.S. at 468, 102 S.Ct. 1169 (“Unlike the Commerce Clause, the Bankruptcy Clause itself contains an affirmative limitation or restriction upon Congress’ power: bankruptcy laws must be uniform throughout the United States.” (emphasis added)); [Kunzler v. Kohaus](#), 5 Hill 317, 324 (N.Y. 1843) (“The power conferred is without restriction, save in its uniformity.”). The court does not place excessive emphasis on one word, particularly an extremely short one, but it is notable that uniformity is described as *the* limitation on the bankruptcy power and not one of the limitations or even the primary one. But see Tabb, *supra*, at 767 (“Two limits

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appear in the Clause: that the law be ‘uniform,’ and that it be ‘on the subject of Bankruptcies.’ ”).

45. As suggested by a broad and supreme power that is not moored to its roots in English bankruptcy law, courts and commentators have also described the ability of the Bankruptcy Clause to adapt to changing conditions, once as bluntly as “The concept changes.” [Wright](#), 304 U.S. at 513, 58 S.Ct. 1025; *see also* [Cont’l Ill.](#), 294 U.S. at 668, 55 S.Ct. 595 (describing a tendency toward “progressive liberalization” of the bankruptcy power since its inception); *Tabb, supra*, at 804 (“[T]he scope of the constitutional grant on the ‘subject of Bankruptcies’ has an expansive and elastic reach”); *Constitutional Limits, supra*, at 567–68 (arguing that even though the automatic stay and discretionary *370 injunction did not exist in early bankruptcy law, they are part of the “subject of Bankruptcies” because they are “logical developments”). “Congress is not limited by what has been attempted in the past but may shape its remedies in a way to meet adequately the problems of the present.” [Campbell](#), 75 F.2d at 955. Throughout the history of American bankruptcy law, the Supreme Court has determined that various changes of a “fundamental and radically progressive nature” are within Congress’s power pursuant to the Bankruptcy Clause. [Marshall](#), 300 B.R. at 520 (quoting [Louisville Joint Stock Land Bank v. Radford](#), 295 U.S. 555, 588, 55 S.Ct. 854, 79 L.Ed. 1593 (1935)). *But see* *Constitutional Limits, supra*, at 500 (claiming the “subject of Bankruptcies” has not changed since the adoption of the Bankruptcy Clause and descriptions of the subject as constantly expanding are “both superficial and myopic”).

[21] [22] [23] [24] 46. Despite forswearing the ability to do so, the Supreme Court has occasionally offered or endorsed definitions of the bankruptcy power. These definitions, however, tend to “result in little more than a paraphrase²⁵ of the language of the Constitution without advancing far toward its full meaning.” [Cont’l Ill.](#), 294 U.S. at 669–70, 55 S.Ct. 595. Bankruptcy jurisdiction “extends to all cases where the law causes to be distributed the property of the debtor among his creditors; this is its least limit. Its greatest is a discharge of the debtor from his contracts. And all intermediate legislation, affecting substance and form, but tending to further the great end of the subject—distribution and discharge—are in the competency and discretion of [C]ongress.” [Klein](#), 14 F. Cas. at 718; *see* *Constitutional*

Limits, supra, at 538 (noting that the Supreme Court has repeatedly expressed its approval of the [Klein](#) definition (citing [United States v. Bekins](#), 304 U.S. 27, 47, 58 S.Ct. 811, 82 L.Ed. 1137 (1938));²⁶ [Radford](#), 295 U.S. at 588 n.18, 55 S.Ct. 854; [Cont’l Ill.](#), 294 U.S. at 669, 55 S.Ct. 595; [Moyses](#), 186 U.S. at 186, 22 S.Ct. 857)). The “subject of Bankruptcies” is “not, properly, anything less than the subject of the relations between an insolvent or non-paying or fraudulent debtor, and his creditors, extending to his and their relief.” [Reiman](#), 20 F. Cas. at 496; *see* *Constitutional Limits, supra*, at 540 n.291 (noting that the Supreme Court endorsed the [Reiman](#) definition in [Wright](#), 304 U.S. at 513–14, 58 S.Ct. 1025, [Radford](#), 295 U.S. at 588 n.18, 55 S.Ct. 854, [Cont’l Ill.](#), 294 U.S. at 672–673, 55 S.Ct. 595, and [Moyses](#), 186 U.S. at 187, 22 S.Ct. 857). “[T]he restructuring of debtor-creditor relations ... is at the core of the federal bankruptcy power” [N. Pipeline Constr. Co. v. Marathon Pipe Line Co.](#), 458 U.S. 50, 71, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982).

47. While the language of the Bankruptcy Clause, the history of American bankruptcy law, and the Supreme Court’s descriptions of the bankruptcy power do not definitively answer, or even directly address, the question of whether constitutional subject matter jurisdiction requires a debtor in financial distress,²⁷ the absence *371 of support for the Committee’s argument is conspicuous. There are simply no cases at any level (of which this court is aware) that explicitly endorse the proposition that bankruptcy courts do not have subject matter jurisdiction unless a debtor has a sufficient degree of financial distress. *See* [Aldrich](#), 2023 WL 9016506, at *4, *16, *33 (observing that there are no cases that hold that financial distress is a constitutional or jurisdictional requirement for debtors). With no precedent for the exact relief it seeks, the Committee argues its position primarily by focusing on the historical meaning of bankruptcy, *see* May 17, 2023 Hr’g Tr. 24:12–25:9 (discussing bankruptcy in ancient Greece, Rome, and Europe); *id.* at 28:15–33:8 (discussing the meaning of bankruptcy from “back in the day” (1777) through the present), references to insolvency and other terms suggesting financial difficulty in dicta, *see* Committee’s Motion at 11 (“I read the constitution thus: ‘Congress shall have power to establish uniform laws on the subject of any person’s general *inability* to pay his debts.’ ” (quoting (and adding emphasis to) [Kunzler](#), 5 Hill at 321)); *id.* at 12 (“The subject of bankruptcies is nothing less than ‘the subject of the relations between an *insolvent or nonpaying*

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or fraudulent debtor, and his creditors, extending to his or their relief.’ ” (quoting (and adding emphasis to) [Wright](#), 304 U.S. at 513–14, 58 S.Ct. 1025)); *id.* at 13 (“[T]he ‘Bankruptcy Code strikes a balance between the interests of insolvent debtors and their creditors.’ ” (quoting (and adding emphasis to) [Bartenwerfer v. Buckley](#), 598 U.S. 69, 72, 143 S.Ct. 665, 214 L.Ed.2d 434 (2023))), and the pleas of commentators about how the bankruptcy system should work (which is not always the same as how it actually operates), *see* Judith K. Fitzgerald, *Over-Thinking Ramifications of the Dismissal of LTL Management LLC’s Bankruptcy*, HARV. L. SCH. BANKR. ROUNDTABLE (Feb. 14, 2023), <https://bankruptcy-roundtable.law.harvard.edu/2023/02/14/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-postscript-and-analysis-of-third-circuit-dismissal-of-ltl-managements-bankruptcy/> (claiming the LTL Opinion “determined that the need for some form of imminent and demonstrable financial relief is foundational to invoking bankruptcy jurisdiction”²⁸); Ralph Brubaker, *The Texas Two-Step and Mandatory Non-Opt-Out Settlement Powers*, HARV. L. SCH. BANKR. ROUNDTABLE (July 12, 2022), <https://bankruptcy-roundtable.law.harvard.edu/2022/07/12/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-the-texas-two-step-and-mandatory-non-opt-out-settlement-powers/> (theorizing that the risk of solvent defendants undercompensating their victims might be acceptable when there is “a clear and present threat to entity viability”); *Constitutional Limits*, *supra*, at 492, 545 (arguing that insolvency is a jurisdictional requirement for bankruptcy).

[25] 48. It is not surprising that the popular understanding of the term “bankruptcy” relates to insolvency or that many bankruptcy opinions include references to insolvency, *see, e.g., Wright*, 304 U.S. at 513–14, 58 S.Ct. 1025 (quoting [Reiman](#), 20 F. Cas. at 496), since most debtors are insolvent, *see In re Ultra Petroleum Corp.*, 51 F.4th 138, 142 (5th Cir. 2022) (“Bankruptcy is ordinarily for the insolvent.”); [Aldrich](#), 2023 WL 9016506, at *17 (observing that “the vast majority” of debtors are insolvent and financially distressed); *Constitutional Limits*, *supra*, at 488 (“[M]ost *372 proceedings under the Code do involve insolvent debtors”). Potential debtors normally do not want to subject themselves to the disclosure requirements and negative societal ramifications (like public disapproval/embarrassment and, for publicly-traded companies, stock market consequences) of a bankruptcy filing unless they

have no other option, and they normally have other options until they are insolvent or very close to it.²⁹ *Cf. Kennedy*, *supra*, at 980 (“A debtor contemplating reorganization under Chapter XI frequently postponed the filing of the petition until losses and deterioration of his financial condition frustrated efforts to accomplish any realistic rehabilitation.”). Some commentators argue in favor of a jurisdictional insolvency requirement, *see, e.g., Bankruptcy and Federalism*, *supra*, at 1064 & 1129 (arguing that Congress can only overrule state law to alter the relationship between insolvent debtors and creditors); *Constitutional Limits*, *supra*, at 488, 492, 545 (claiming that insolvency is a jurisdictional requirement), but courts, including this one, have rejected a rule requiring debtors to be insolvent, *see, e.g., LTL*, 64 F.4th at 102 (noting the lack of an insolvency requirement); [Bestwall](#), 605 B.R. at 49 (“[F]iling for Chapter 11, especially in the context of an asbestos or mass tort case, need not be due to insolvency.”); [In re Mid-Valley, Inc.](#), 305 B.R. 425, 429 (Bankr. W.D. Pa. 2004) (Fitzgerald, J.) (“The Bankruptcy Code does not require that a debtor be insolvent.”); [Marshall](#), 300 B.R. at 509 (holding that the Bankruptcy Clause does not require insolvency), 519 (“[I]t is not credible that the framers of the Constitution thought that a requirement of insolvency was included in the concept of bankruptcy that found its way into the Bankruptcy Clause.”), and no court has held that insolvency is a prerequisite for constitutional subject matter jurisdiction. References to insolvency in bankruptcy opinions are dicta, *see, e.g., Bartenwerfer*, 598 U.S. at 72, 143 S.Ct. 665 (referring to the Bankruptcy Code’s balance between insolvent debtors and creditors in the first sentence of the opinion); [Kunzler](#), 5 Hill at 320 (asserting that “bankruptcy” is synonymous with “insolvency”), and the court is not bound by dicta, *see Katz*, 546 U.S. at 363, 126 S.Ct. 990 (citing [Cohens v. Virginia](#), 6 Wheat. 264, 399–400, 5 L.Ed. 257 (1821)).

49. In addition, “insolvency” and “financial distress” do not mean the same thing, [LTL](#), 64 F.4th at 102 (“To say, for example, that a debtor must be in financial distress is not to say it must necessarily be insolvent.”), and the Committee explicitly and emphatically rejects the concept of an insolvency requirement for bankruptcy jurisdiction, Official Committee of Asbestos Claimants’ Consolidated Reply in Support of the Committee’s Motion to Dismiss for Lack of Subject Matter Jurisdiction (Dkt. 2993) (“Committee’s Reply”) at 8 (“[T]he Committee *does not* argue that an

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entity must be insolvent to file for bankruptcy.”). There are several ways to define “insolvency,” two of which are regularly used in bankruptcy: (1) balance sheet insolvency, and (2) the liquidity (or “equity” or “cash flow”) test for insolvency. [Marshall](#), 300 B.R. at 511–513. Generally, balance sheet insolvency means a debtor’s total debt exceeds the value of its property. *Balance-sheet insolvency*, BLACK’S LAW DICTIONARY (9th ed. 2009) (“Insolvency created when *373 the debtor’s liabilities exceed its assets.”). The Bankruptcy Code includes its own modified versions of balance sheet insolvency applicable to entities other than municipalities. 11 U.S.C. § 101(32)(A)–(B). Courts use the Code’s versions of balance sheet insolvency primarily “to define narrowly drawn rights under particular statutory provisions,” [Marshall](#), 300 B.R. at 512 (citing §§ 365, 525, 541, 543, 545, 546, 547, 548, 553), and they are not used to determine debtor eligibility.

50. The liquidity test for insolvency does not compare a debtor’s assets and liabilities. Instead, it looks at whether a debtor is promptly paying its debts. *Equity insolvency*, BLACK’S LAW DICTIONARY (9th ed. 2009) (“Insolvency created when the debtor cannot meet its obligations as they fall due.”). The Bankruptcy Code includes a version of the liquidity test in [section 101\(32\)\(C\)](#) that courts use to determine the eligibility of municipalities to file bankruptcy under Chapter 9. See § 109(c)(3).³⁰ It is the only type of insolvency ever used to determine debtor eligibility for bankruptcy in the United States. [Marshall](#), 300 B.R. at 512.

51. While insolvency examines whether a debtor’s liabilities exceed its assets (literally for balance sheet insolvency and figuratively under the liquidity test), financial distress is a more nebulous concept that implies a less severe degree of financial trouble than insolvency. The LTL Opinion, which the Committee (understandably) puts great stock in, does not attempt to define “financial distress.” [LTL](#), 64 F.4th at 102 (“[W]e need not set out any specific test to apply rigidly when evaluating financial distress.”), 110 (“[W]hile 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.”). The concept is so vague that the Committee does not attempt to precisely define it despite asking this court to determine that it is implicitly required by the Bankruptcy Clause. See Committee’s Motion at 20 (asserting that “[t]his

court need not determine where the constitutional line is” because it is so clear that the Debtor is not in financial distress). The court accepts the Committee’s argument that the Debtor has never been in financial distress in the sense that its access to the funding agreement, and, therefore, Georgia-Pacific’s assets, makes it able to pay any conceivable liabilities now and in the foreseeable future (and the Debtor does not argue to the contrary), but the requirements of constitutional subject matter jurisdiction, especially given the potentially drastic consequences of the lack thereof, [see infra](#) ¶ 53, need to be definable. As previously noted, no court has ever concluded that financial distress is a requirement for constitutional subject matter jurisdiction, and there is some indication in the case law that it is not, [see, e.g., United States v. Huebner](#), 48 F.3d 376, 379 (9th Cir. 1994) (“The Bankruptcy Act³¹ does not require any particular degree of financial distress as a condition precedent to a petition seeking relief.”); *374 [Rudd v. Laughlin](#), 866 F.2d 1040, 1041–42 (8th Cir. 1989) (“[T]he statutes governing the authority of federal courts to hear bankruptcy cases do not limit jurisdiction according to amounts involved.”); [In re Honx, Inc.](#), No. 22-90035, 2022 WL 17984313, at *2 (Bankr. S.D. Tex. Dec. 28, 2022) (concluding that a debtor with asbestos liability did not commence its case in bad faith because “Congress recognized that ... an asbestos bankruptcy differs from a ‘classic’ bankruptcy with an insolvent or near-insolvent debtor”); [In re Gen. Growth Props., Inc.](#), 409 B.R. 43, 60 (Bankr. S.D.N.Y. 2009) (declining to establish a rule that debtors cannot file bankruptcy unless their debt is due within a particular period of time); [In re Mirant Corp.](#), No. 03-46590, 2005 WL 2148362, at *12–13 (Bankr. N.D. Tex. Jan. 26, 2005) (using laches to deny motions to dismiss despite allegation that the debtor “was highly solvent and financially healthy on the date of its bankruptcy filing and has continued to be so since that date”).

52. Given the lack of support in bankruptcy history for a financial distress requirement, the relative abundance of references to insolvency (and, at least in relevant scholarship, support for an insolvency requirement), and the similarity of the two concepts (i.e., both look at the financial problems of a debtor), it is not surprising or unreasonable for the Committee to use references to insolvency to support its argument, but the Committee’s rejection of the implications of most of the authorities it cites for support undermines its position. For example, the Committee says “a debtor’s eligibility to

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be a proper ‘subject of Bankruptc[y]’ within the meaning of the Bankruptcy Clause ‘is a jurisdictional requirement for invoking a bankruptcy proceeding,’ ” quoting Professor Plank. Committee’s Motion at 17 (quoting *Constitutional Limits*, *supra*, at 492). Professor Plank’s full assertion, however, is that “[t]he *insolvency* of the debtor in this sense [i.e., in the sense of balance sheet or liquidity insolvency] is a jurisdictional requirement for invoking a bankruptcy proceeding.” *Constitutional Limits*, *supra*, at 492 (emphasis added). The Committee uses Professor Plank’s contention, which advocates a position that the Committee explicitly disclaims (that insolvency is a jurisdictional requirement), to support its claim that a different concept, financial distress, is a jurisdictional requirement. Similarly, the LTL Opinion prompted the Committee’s Motion to some extent, *see* Committee’s Motion at 9 (“In light of the *LTL Mgmt.* decision ... , the Committee believes that the Court should now address whether Bestwall is constitutionally eligible to be a debtor in bankruptcy.” (footnote omitted)), and the Committee cites it for support, *see* May 17, 2023 Hr’g Tr. 18:8–10 (“[T]he language in *LTL* is entirely consistent with what we believe is the constitutional limitation on a company that seeks to access the bankruptcy laws.”). In that case, however, the Third Circuit determined that it and the bankruptcy court below had subject matter jurisdiction, *LTL*, 64 F.4th at 99 (“The Bankruptcy Court had jurisdiction of the bankruptcy case under, *inter alia*, 28 U.S.C. §§ 157(a) and 1334(a). We have jurisdiction of the appeals under 28 U.S.C. § 158(d)(2)(A).” (footnote omitted)), prior to determining that the debtor did not file its case in good faith due to its lack of financial distress, *id.* at 110. The Committee’s need to reach for authorities that advocate a different (but related) argument shows the lack of support for its contention.

53. One reason for the lack of support for a constitutional financial distress requirement is the difficulty in administering such a rule. Professor Plank, a leading *375 proponent of the insolvency requirement (which no party to this case supports), says “there does not seem to be any principled way” to administer a financial distress requirement. *Constitutional Limits*, *supra*, at 493 n.23. At the hearing on the Motions to Dismiss, the advocates for the requirement disagreed about whether financial distress should be determined at the outset of a case or throughout the proceedings. On the one hand, despite citing post-petition developments as support, the Committee took the position that it was a “gatekeeping or access-to-bankruptcy

question,” May 17, 2023 Hr’g Tr. 43:19–20, and was not sure what should happen if subsequent events showed a debtor to be solvent, *id.* at 44:6–10. On the other hand, the attorney representing certain claimants represented by Maune, Raichle, Hartley, French & Mudd, LLC (“Maune Raichle”), *id.* at 46:22–47:11, and the attorney for Mr. Buckingham, *id.* at 107:21–108:13, argued that the court has a continuing duty throughout its cases to constantly assess its jurisdiction and dismiss any case, at any point in the case, when a debtor is not in financial distress. The latter position is arguably more consistent with a constitutional jurisdiction requirement since courts must always assess their subject matter jurisdiction, *see, e.g., Valley Historic*, 486 F.3d at 838 (“We do not find that these principles and our precedent, however, can be read or extended to preclude the bankruptcy court from exercising its unflagging obligation to examine its subject matter jurisdiction at every stage of the proceeding.”), but determining that subject matter jurisdiction was lost due to post-petition developments would be contrary to both the Bankruptcy Code and long-standing traditions of bankruptcy practice, *see, e.g.,* § 726(a)(5) & (6) (authorizing payment of interest and refunds to a Chapter 7 debtor when all claims are paid in full); *Ultra Petroleum*, 51 F.4th at 150 (“For some three centuries of bankruptcy law, courts have held that an equitable exception to the usual rules applies in the unusual case of a solvent debtor.”);³² *see also Bankruptcy & Federalism*, *supra*, at 1112–13 (noting that § 726(a)(5) allows “greater payments to creditors in bankruptcy than they would receive outside of bankruptcy” without addressing the apparent solvency of the debtor’s estate in a situation where the provision is invoked). A rule that subject matter jurisdiction is lost when a determination is made post-petition that a debtor is no longer in financial distress would create a perverse incentive for Chapter 7 trustees, whose compensation is based on the assets recovered, not to find too many assets.³³ Likewise, many Chapter 13 cases end with early discharges and full payments to creditors as a result of the appreciation of the value of real property, an inheritance, or some other financial good fortune. *See, e.g., In re Miloni*, No. 20-30258, slip op. at 1–2 (Bankr. W.D.N.C. Nov. 8, 2023) (approving sale of debtor’s real property with proceeds to pay off Chapter 13 plan at 100% and surplus refunded to the debtor and noting post-petition appreciation of the real property). Under the version of the financial distress rule advocated by Mr. Buckingham and Maune Raichle, these Chapter 13 cases could instead conclude with dismissal

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due to the court's post-petition ^{*376} loss of subject matter jurisdiction. Bankruptcy courts could also face attempts to revoke confirmation of Chapter 11 and 13 plans and the discharge of debtors after cases close based on allegations of a lack of financial distress. Cf. *In re Tatsis*, 72 B.R. 908, 911 (Bankr. W.D.N.C. 1987) ("There are many instances in which Chapter 13 cases are filed where the qualifications of the debtor under § 109(e) might be called into question. In such a case, when no issue is raised by a party in interest, the case will be administered pursuant to Chapter 13. Can someone then come one, two, or three years after confirmation and question the jurisdiction of the court? Can a creditor sue a debtor after his discharge in Chapter 13, alleging that the bankruptcy court never had jurisdiction? These are questions that Congress never intended this Court or any other bankruptcy court be required to answer.").

54. Whether assessed only at the beginning of a case or throughout, determining whether a debtor is in financial distress would not be easy. As previously mentioned, the Committee is not concerned with a standard for the determination because it asserts that this case is not a close call. See Committee's Reply at 16 ("Experience up until now has not required courts to further clarify those limits (and even now this Court does not have to define the dividing line)."). But a constitutional rule would apply to all of the cases before the court, now and in the future, so the court needs to have some idea of how to enforce it. Other courts and commentators have noted the difficulty of enforcing a theoretical insolvency rule, see, e.g., *Marshall*, 300 B.R. at 513 (noting the extensive amount of time necessary to make a solvency determination); *Constitutional Limits*, *supra*, at 493 ("To be sure, whether and when a debtor becomes insolvent in either sense may present difficult factual and conceptual questions."), and insolvency is a defined and familiar concept compared to financial distress.³⁴ Any consideration of the practicalities of a financial distress rule leads to more questions than answers. The Committee and its allies may not be concerned with the logistics of applying its rule in contexts other than this unusual case, but the court would have to apply a constitutional rule across the board, and very few debtors have access to the resources of Fortune 500 companies.

55. Another problem with a financial distress requirement for subject matter jurisdiction is the tension with the goal of

getting potential debtors to commence their cases early. In adopting the Bankruptcy Code, Congress saw the benefit in incentivizing Chapter 11 debtors to file their cases in time to maintain the value of their estates and avoid liquidation.³⁵ *Gen. Growth*, 409 B.R. at 60; *In re Johns-Manville Corp.*, 36 B.R. 727, 736 (Bankr. S.D.N.Y. 1984); Kennedy, *supra*, at 980–81; REPORT, *supra*, at 75. Under the Committee's rule, however, debtors would have to thread the needle between filing early enough to preserve value as encouraged by the Code but not filing too early and therefore facing dismissal (or the threat thereof) for an absence of sufficient financial distress. In addition, the assessment of financial distress by courts would itself cause some loss of value. Cf. *Marshall*, 300 B.R. at 513 ("If a reorganization is held up pending a determination of balance sheet insolvency, businesses will rarely be reorganized, and at least some of the reorganization ^{*377} value (the value of a business as reorganized as opposed to its liquidation value) will inevitably be lost.").

56. Consistent with a policy decision to allow liberal access and encourage early filing, Congress did not make the statutory subject matter jurisdiction requirements for bankruptcy very strenuous. While the instant dispute focuses on the Constitution, the court notes that this case satisfies the modest statutory requirements for subject matter jurisdiction. Section 1334 of Title 28 determines statutory subject matter jurisdiction for bankruptcy. *Kirkland*, 600 F.3d at 315; *Valley Historic*, 486 F.3d at 839 n.3; *Houck v. Lifestore Bank (In re Houck)*, Ch. 13 Case No. 11-51513, Adv. No. 15-5028, 2018 WL 722462, at *7 (Bankr. W.D.N.C. Feb. 5, 2018). Section 1334(a) gives district courts jurisdiction over the administration of bankruptcy cases, and section 1334(b) provides district courts with jurisdiction over all of the discrete proceedings within the cases. *Houck*, 2018 WL 722462, at *7. Section 157 of Title 28 allows district courts to send bankruptcy matters to bankruptcy courts, and the District Court's April 14, 2014 Amended Standing Order of Reference sends all local cases to this court. The statutes that establish the subject matter jurisdiction of the bankruptcy court do not look at financial distress, insolvency, or any other characteristics of debtors.

[26] [27] 57. Accordingly, if Congress decided to add a financial distress requirement for debtors in bankruptcy, it would most likely not implicate the subject matter jurisdiction of the court. Congress would likely add the requirement to

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section 109, which “defines who may be a debtor under the various chapters of the Code.” [Toibb v. Radloff](#), 501 U.S. 157, 160, 111 S.Ct. 2197, 115 L.Ed.2d 145 (1991); *see also* Kennedy, *supra*, at 986 (similar). Section 109’s requirements for debtor eligibility are not jurisdictional. *In re Zarnel*, 619 F.3d 156, 169 (2d Cir. 2010); *Rudd*, 866 F.2d at 1042 (citations omitted); *see also In re Phillips*, 844 F.2d 230, 235 n.2 (5th Cir. 1988) (section 109(g) is not jurisdictional); *In re Stinnie*, 555 B.R. 530, 533 (Bankr. W.D. Va. 2016) (section 109(h) is not jurisdictional); *In re Baxter*, Ch. 7 Case No. 06-30452, slip op. at 8 (Bankr. W.D.N.C. May 17, 2006) (section 109(h) is not jurisdictional). *But see In re Keziah*, 46 B.R. 551, 554 (Bankr. W.D.N.C. 1985) (“§ 109 is a part of the eligibility (to be a debtor) section which involves the subject matter jurisdiction of this Court.”).³⁶ In municipal bankruptcies, which do require insolvency, the requirement is in section 109(c), and it is not jurisdictional. *Hamilton Creek*, 143 F.3d at 1385 n.2. A bankruptcy case commences even if a debtor is not eligible under a particular chapter, *see, e.g., Tatsis*, 72 B.R. at 910 (“Movant argues that in the event a debtor files a petition pursuant to Title 11, but chooses a chapter for which he is not qualified, then there is no jurisdiction of any kind or type in the court and the filing is a nullity. This argument is incorrect.”), or at all, *see, e.g., Zarnel*, 619 F.3d at 169 (“[W]e find that the restrictions of § 301 and § 109(h) are not jurisdictional, but rather elements that must be established to sustain a voluntary bankruptcy *378 proceeding.”); *see also* Kennedy, *supra*, at 983 (“Filing the petition results in an automatic entry of an order for relief under the chapter invoked by the petition. The expression ‘order for relief’ in the Code is equivalent to adjudication under the Bankruptcy Act and is tantamount to an order approving the court’s exercise of jurisdiction to grant relief pursuant to the provisions of the law. If the debtor is ineligible or the petition is insufficient, however, the language of the statute does not preclude the court from taking whatever action is appropriate to dispose of the document.” (footnotes omitted)); *REPORT, supra*, at 75 (“There should be no legal barrier to voluntary petitions.”). If debtor eligibility was an element of subject matter jurisdiction, a case commenced by an ineligible debtor would instead be void. *See Baxter*, slip op. at 7 (“Some courts maintain that compliance with Section 109(h) is jurisdictional and a filing by a debtor who does not qualify is a nullity.” (citations omitted)); *cf. Arbaugh*, 546 U.S. at 514, 126 S.Ct. 1235 (“[W]hen a federal court concludes that it lacks subject-matter jurisdiction, the court

must dismiss the complaint in its entirety.” (citing 16 JAMES WM. MOORE ET AL., *MOORE’S FEDERAL PRACTICE* § 106.66[1], at 106-88 to 106-89 (3d ed. 2005)).

58. In part due to the harsh results of a decision that subject matter jurisdiction is lacking, the Supreme Court has been trying “to bring some discipline” to the jurisdictional analysis in recent years. *MOAC*, 598 U.S. at 298, 143 S.Ct. 927 (quoting *Henderson v. Shinseki*, 562 U.S. 428, 435, 131 S.Ct. 1197, 179 L.Ed.2d 159 (2011)). The Eleventh Circuit, applying the Supreme Court’s guidance in the bankruptcy context, noted that “the failure of a cause of action does not automatically produce a failure of jurisdiction.” *In re Trusted Net Media Holdings, LLC*, 550 F.3d 1035, 1042 (11th Cir. 2008) (quoting *Steel Co. v. Citizens for a Better Env’t*, 523 U.S. 83, 91, 118 S.Ct. 1003, 140 L.Ed.2d 210 (1998)); *see also id.* at 1043 (concluding that the requirements of § 303 for involuntary cases are not jurisdictional). The Supreme Court addressed subject matter jurisdiction multiple times in 2023, including a determination of whether a bankruptcy statute implicated subject matter jurisdiction. *See MOAC*, 598 U.S. at 292, 143 S.Ct. 927 (deciding that § 363(m) is not jurisdictional); *Santos-Zacaria*, 598 U.S. at 413, 143 S.Ct. 1103 (holding that an immigration law (8 U.S.C. § 1252(d)(1)) is not jurisdictional). In *MOAC*, the Court observed that “[t]he ‘jurisdictional’ label is significant because it carries with it unique and sometimes severe consequences.” 598 U.S. at 297, 143 S.Ct. 927. While these decisions deal with statutory subject matter jurisdiction, they suggest the Supreme Court would not favor expansive new ideas about constitutional subject matter jurisdiction for similar reasons.

59. There is no need for a harsh new jurisdictional rule because there are other ways for courts to address any perceived abuse by debtors lacking financial distress. *Cf. Constitutional Limits, supra*, at 555 (“The requirement of good faith, the ability to lift the automatic stay for cause, and the discretion to disapprove rejection of contracts may be sufficient to prevent solvent debtors from abusing the bankruptcy process.”). As previously noted, the LTL Opinion is a basis for the Committee’s Motion. *See supra* ¶¶ 51–52. In contrast with the Committee’s Motion, however, the Third Circuit decided that it had jurisdiction, *LTL*, 64 F.4th at 99, and dismissed the LTL case pursuant to section 1112(b) because the debtor could not show that it commenced its case in good faith due to its *379 lack of financial distress, *id.*

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at 110.³⁷ The LTL Opinion is not the only example of a court using good faith to police against financially healthy debtors abusing the bankruptcy system. See, e.g., *In re Cedar Shore Resort, Inc.*, 235 F.3d 375, 381 (8th Cir. 2000) (“Nor did the bankruptcy court abuse its discretion in dismissing Cedar Shore’s petition. 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.’ ” (quoting *Furness v. Lilienfeld*, 35 B.R. 1006, 1009 (D. Md. 1983))); *In re SGL Carbon Corp.*, 200 F.3d 154, 164 (3d Cir. 1999) (“SGL Carbon cites no case holding that petitions filed by financially healthy companies cannot be subject to dismissal for cause.”); *Constitutional Limits*, *supra*, at 548–551 (collecting cases). Some courts even find “cause” under section 362 to grant relief from the automatic stay when a debtor files a case in bad faith. See, e.g., *In re Corp. Deja Vu*, 34 B.R. 845, 850 (Bankr. D. Md. 1983) (“The petition was filed in bad faith. This bad faith constitutes cause to allow the secured creditor relief from the stay.”); *Constitutional Limits*, *supra*, at 551 (citing *In re Dixie Broad., Inc.*, 871 F.2d 1023 (11th Cir.), *cert. denied*, 493 U.S. 853, 110 S.Ct. 154, 107 L.Ed.2d 112 (1989)). In addition, some courts deny access to special bankruptcy rules and protections based on a debtor’s solvency without examining good faith. See, e.g., *Claughton v. Mixson*, 33 F.3d 4, 6–7 & n.4 (4th Cir. 1994) (affirming bankruptcy court’s lifting of stay due to debtor’s solvency); *Constitutional Limits*, *supra*, at 551–52 (collecting cases including *Claughton*). There are many tools available for bankruptcy courts to deal with a debtor’s lack of financial distress without a new rule of subject matter jurisdiction.

60. Based primarily on its analysis of the history of the Bankruptcy Clause and the Supreme Court’s interpretation of Congress’s expansive power pursuant to it, this court holds that financial distress is not a prerequisite for bankruptcy subject matter jurisdiction pursuant to the Constitution. Instead, the court joins others that have held that the subject matter jurisdiction for bankruptcy extends to all cases filed under the Bankruptcy Code. See, e.g., *Zarnel*, 619 F.3d at 169 (“Restricting whether an individual may be a debtor either under the Bankruptcy Code in general or under a given chapter does not *380 speak in jurisdictional terms or invoke the jurisdiction of the district court, delineated in 28 U.S.C. § 1344 as discussed above.”); *Rudd*, 866 F.2d

at 1041 (“When a petition is filed in a bankruptcy court seeking assistance in ‘the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power,’ the court has jurisdiction to administer the ensuing case in accordance with Title 11 of the United States Code.” (quoting *N. Pipeline*, 458 U.S. at 71, 102 S.Ct. 2858)); *Auto. Pros.*, 370 B.R. at 167 (citing *Phillips*, 844 F.2d at 236 n.2); *Baxter*, slip op. at 7–8 (agreeing with courts that take the position that “it is the petition that invokes the bankruptcy court’s jurisdiction, not the debtor’s characteristics”); see also *Mussman & Riesenfeld*, *supra*, at 92 (“The jurisdiction of the court attaches from the filing of the petition”). The Founding Fathers, like many contemporary observers, might be surprised that an entity like the Debtor with access to significant financial resources has sought bankruptcy protection. Their presumed astonishment, however, does not mean that the Debtor has violated the subject matter jurisdiction of the bankruptcy court, and the question of whether the Debtor should be able to access the bankruptcy system is different than the question of whether the Constitution bars it. Accordingly, the court emphasizes the limited nature of this jurisdictional ruling. The court is not making a policy judgment that a debtor without financial distress should be able to file bankruptcy; it is simply deciding that the limited language of the Bankruptcy Clause, as interpreted by the Supreme Court over the last 250 years, does not prevent the Debtor from doing so.

Conclusion

While framed as new arguments, the Buckingham Motion and portions of the Committee’s Motion actually seek reconsideration of this court’s prior Opinion and Order on the Debtor’s good faith without satisfying the standard for reconsideration. The law of the case doctrine counsels against a court straying from its previous legal conclusions. Furthermore, the divestment rule prevents a court from addressing issues on appeal, and the Committee’s attempt to appeal the Opinion and Order was pending in the District Court when the Motions to Dismiss were filed, argued, and ruled on.

In addition to the good faith argument, the Committee’s Motion asserts a new basis for dismissal: an absence of constitutional subject matter jurisdiction based on

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the Debtor's lack of financial distress. After analyzing the Bankruptcy Clause of the Constitution and its interpretation by the Supreme Court, other courts, and outside commentators, the court is confident that the Constitution does not require debtors to have financial distress in order for bankruptcy courts to have subject matter jurisdiction. The court's conclusion is buttressed by the complete lack of support for the Committee's novel argument in the relevant case law, the practical problems with a jurisdictional financial distress requirement, the policy decision to encourage potential debtors to file their cases early, the Supreme Court's recent approach to issues of subject matter jurisdiction, and

the ability of bankruptcy courts to use other tools to address the problem asserted by the Committee.

Based on these findings and conclusions, and for the additional reasons set forth on the record at the July 28, 2023 hearing (which record is incorporated herein), the Motions to Dismiss are hereby **DENIED**.

SO ORDERED.

All Citations

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Footnotes

- 1 Docket references in this order are to the docket for this case unless otherwise indicated.
- 2 The court's jurisdictional conclusions are explained in (far) more depth later in this order. See infra ¶¶ 25–60.
- 3 This is an oversimplified description of the divisive merger performed by Old GP intended to provide sufficient context for the following discussion of the Motions to Dismiss. While the Texas Two-Step transaction informs the entirety of this case, it is not directly relevant to the Motions to Dismiss. See, e.g., May 17, 2023 Hr'g Tr. 136:11–14 (Buckingham's counsel answering “Absolutely” when asked by the court if the Buckingham Motion would have been filed if there was no divisional merger and the debtor in this case was Georgia-Pacific).
- 4 Subsequent statutory references in this order are to Title 11 unless otherwise indicated.
- 5 In its Certification for Direct Appeal, the court concluded that directly certifying the appeal to the Court of Appeals materially advanced the Debtor's case because the issue of reconsidering the [Carolin](#) standard would require a determination by the Fourth Circuit. Certification for Direct Appeal at 3. The court also concluded that the Opinion and Order involved a matter of public importance because the pre-petition restructuring created an issue of first impression in the Fourth Circuit regarding the subjective bad faith prong of the [Carolin](#) standard that “transcends this case, its litigants, and asbestos cases in general.” Certification for Direct Appeal at 4.
- 6 “W.D.N.C.” docket references are to the District Court's docket in case no. 19-396, the Committee's appeal of the Opinion and Order.
- 7 The Debtor further explains that in its jurisdictional analysis, the Fourth Circuit “rejected the Committee's attempts to invoke the [LTL Opinion] because, among other things, the Fourth Circuit ‘applies a more comprehensive standard’ for a bad-faith dismissal than the Third Circuit, looking to both ‘subjective bad faith’ and ‘objective futility of any possible reorganization.’” Debtor's Notice at 1–2 (quoting [Off. Comm. of Asbestos Claimants](#), 71 F.4th at 182).

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- 8 Subsequent to the court issuing its oral ruling on the Motions to Dismiss but prior to the entry of this order memorializing that ruling, the District Court entered an Order on November 7, 2023 denying the Committee's motion for leave to appeal, denying as moot the Debtor's Motion for Leave, and dismissing the [Committee's appeal](#). [In re Bestwall LLC, No. 19-cv-00396, slip op. at 10, 2023 WL 7361075 \(W.D.N.C. Nov. 7, 2023\)](#). The District Court first concluded that the Opinion and Order is not appealable as a final order. [Id.](#) at 4–7. It then considered and denied the Committee's request for leave to appeal the Opinion and Order. [Id.](#) at 7–10. The District Court concluded that: (1) an appeal of the Opinion and Order does not involve a controlling question of law because this court applied [Carolin](#), which is binding law in this circuit; (2) “there is not substantial ground for difference of opinion” about the test to use in the context of motions to dismiss under section 1112(b) in the Fourth Circuit; and (3) the Committee had not shown the exceptional circumstances required to ignore the policy of postponing appellate review until a final judgment has been entered. [Id.](#) at 9–10.
- 9 “A.P.” docket references are to this court's docket in adversary proceeding no. 17-3105.
- 10 In his reply in support of the Buckingham Motion and in his oral argument at the hearing on March 15, 2023, Mr. Buckingham's counsel characterized his argument as one of subject matter jurisdiction. However, at the May 17, 2023 hearing, Mr. Buckingham's counsel seemed to abandon that argument and focused on dismissal of the case as a bad faith filing under [Carolin](#). [See, e.g.,](#) May 17, 2023 Hr'g Tr. 118:10–17.
- 11 In non-bankruptcy federal litigation like [Levin](#), the district court is the trial court, and the court of appeals is the (initial) appellate court. In bankruptcy matters, the bankruptcy court is the trial court, and the initial appeal goes to the district court (or, in certain other circuits, a bankruptcy appellate panel). [See, e.g., FED. R. BANKR. P. 8003](#) (Appeal as of Right—How Taken; Docketing the Appeal), 8005 (Election to Have an Appeal Heard by the District Court Instead of the BAP).
- 12 After the District Court's November 7, 2023 decision not to allow an interlocutory appeal of this court's ruling on the First Motion to Dismiss, Mr. Buckingham filed a Notice of Supplemental Authority (Dkt. 3172) that reports the District Court's denial of the Committee's motion for leave to appeal and asks the court to rule on the merits of his motion to dismiss. The court declines the invitation. First, the court announced its ruling at the July 28, 2023 hearing, prior to the District Court's denial of the Committee's motion for leave to appeal, and this order memorializes that ruling. In addition, and more importantly, even if the District Court's ruling occurred prior to the July 28 hearing, the court would not have gotten to the merits of the Buckingham Motion. The court already ruled on the bad faith arguments at the heart of the Buckingham Motion, and the end of the appeal would not lead this court to reconsider its previous conclusions for the reasons explained in this order. [See, e.g., supra](#) ¶ 20.
- 13 If this debate is not jurisdictional, it is about congressional power pursuant to the Bankruptcy Clause. [Aldrich, 2023 WL 9016506, at *12–14](#).
- 14 The Debtor's law of the case argument on the subject matter jurisdiction issue focuses on this court's previous conclusion in the Opinion and Order that “[t]he volume of current asbestos claims that Bestwall faced as of the Petition Date, coupled with the projected number of claims to be filed through 2050 and beyond, is sufficient financial distress for Bestwall to seek resolution under [section 524\(g\) of the Bankruptcy Code](#).” [Bestwall, 605 B.R. at 49](#). While the court's previous order speaks for itself, the court was not considering subject matter jurisdiction in that order, and, as the context of the entire sentence makes clear, the court was only considering the evidence before it about the (significant) liabilities faced by the Debtor and was not considering the Debtor's (more significant) assets, [cf. LTL, 64 F.4th at 104](#) (“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.”); [Aldrich, 2023 WL 9016506, at *15](#) (explaining argument that the court must consider the denominator (i.e., revenues/cash flow) as well as the numerator (i.e., asbestos liability) in determining financial distress).

- 15 As mentioned *supra* ¶ 8, the Committee's Motion refers to the Debtor's financial situation at its petition date and since then, so it is not clear whether the court should examine the Debtor's alleged lack of financial distress as of the petition date over 6 years ago, now, or both. Similarly and as discussed further *infra* ¶53, at the hearing on the Motions to Dismiss, the advocates for the Committee's position disagreed about whether the court should determine subject matter jurisdiction only as of the petition date or throughout the case.
- 16 Until the 18th century, bankruptcy and insolvency were two separate (but related) bodies of substantive law. Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 516 (1996) (observing that English bankruptcy and insolvency law began to merge in 1758). The Supreme Court has determined that the Bankruptcy Clause encompasses both types of law. [Cont'l Ill. Nat'l Bank & Tr. Co. of Chi. v. Chi., Rock Island & Pac. Ry. Co.](#), 294 U.S. 648, 667–68, 55 S.Ct. 595, 79 L.Ed. 1110 (1935) (“While attempts have been made to formulate a distinction between bankruptcy and insolvency, it long has been settled that, within the meaning of the constitutional provision, the terms are convertible.”); [Sturges v. Crowninshield](#), 17 U.S. 122, 195, 4 Wheat. 122, 4 L.Ed. 529 (1819) (“This difficulty of discriminating with any accuracy between insolvent and bankruptcy laws, would lead to the opinion, that a bankrupt law may contain those regulations which are generally found in insolvent laws; and that an insolvent law may contain those which are common to a bankrupt law.”) (Marshall, C.J.).
- 17 There is disagreement among authorities about when both English and American bankruptcy relief became available to debtors who were not traders. *See infra* ¶ 33, nn.19–20.
- 18 While very few opinions consider a debtor's degree of financial distress, and many of the authorities (including the majority of the sources cited by the Committee as support for its argument) discuss a debtor's financial condition in terms of insolvency, it is important to recognize that “insolvency” and “financial distress” are not synonymous. *See infra* ¶¶ 49–51.
- 19 Professor Plank claims that English bankruptcy law of the 18th century had already expanded beyond traders prior to 1787. *Constitutional Limits, supra*, at 541 n.309.
- 20 [Marshall](#) says the “second landmark major development” of the 1841 Act was the extension of bankruptcy law to non-traders. 300 B.R. at 520.
- 21 The filing of a petition constitutes the “order for relief” in a voluntary case. 11 U.S.C. § 301(b).
- 22 William Blackstone, whose “*Commentaries* rank second only to the Bible as a literary and intellectual influence on the history of American institutions,” William D. Bader, *Some Thoughts on Blackstone, Precedent, and Originalism*, 19 VT. L. REV. 5, 8 (1994) (quoting ROBERT A. FERGUSON, LAW AND LETTERS IN AMERICAN CULTURE 11 (1984)), thoroughly considered English bankruptcy law and did not include insolvency as a requirement. [Marshall](#), 300 B.R. at 517 (citing 2 WILLIAM BLACKSTONE, COMMENTARIES *471–88).
- 23 *Black's Law Dictionary* defines “plenary” as “Full; complete; entire.” *Plenary*, BLACK'S LAW DICTIONARY (9th ed. 2009).

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- 24 Concerns about subject matter jurisdiction presumably did not limit the bankruptcy authority of Parliament and the pre-Constitution states.
- 25 The lengthier of these definitions might be more like the opposite of a paraphrase since a paraphrase is usually shorter and simpler than the original statement.
- 26 Despite the citation in *Constitutional Limits*, the [Bekins](#) opinion does not actually discuss the [Klein](#) definition at all. It does, however, quote the [Reiman](#) formulation of the bankruptcy power. [Bekins](#), 304 U.S. at 47, 58 S.Ct. 811.
- 27 [But see Gibbons](#), 455 U.S. at 476, 102 S.Ct. 1169 (Marshall, J., concurring) (“Congress may specify what debtors ... will be subject to bankruptcy legislation.”).
- 28 Judge Fitzgerald appears to be using the word “jurisdiction” loosely in the quoted phrase. [See infra](#) n.36, ¶ 58.
- 29 Texas Two-Step cases like this one, where an existing company (Georgia-Pacific here) creates a separate entity like the Debtor in order to gain access to benefits available only in bankruptcy for itself, appear to be an exception to this rule. [Cf. Bankruptcy and Federalism](#), *supra*, at 1095 (contending that an insolvency requirement would prevent solvent debtors from taking advantage of bankruptcy rules that are not available elsewhere).
- 30 Municipalities must be insolvent to be debtors, but the requirement is included in section 109 and does not implicate the court's subject matter jurisdiction. [See In re Hamilton Creek Metro. Dist.](#), 143 F.3d 1381, 1385 n.2 (10th Cir. 1998) (noting that “none of the § 109(c) criteria is [sic] jurisdictional in nature” while determining that a Chapter 9 debtor “did not meet the essential criterion of insolvency”); [see also infra](#) ¶ 57.
- 31 [Huebner](#) deals with the appeal of tax evasion convictions involving bankruptcy petitions filed in 1985 and 1986, [see 48 F.3d at 377–79](#), well after the effective date of the Bankruptcy Code, so the reference to the Bankruptcy “Act” appears to be in error.
- 32 The [Ultra Petroleum](#) court described its debtor as becoming “supremely solvent,” [51 F.4th at 142](#), “massively solvent,” [id. at 143](#), and, fittingly, “ultra solvent,” [id. at 150](#), due to a post-petition increase in the price of natural gas.
- 33 The incentive for a Chapter 7 trustee not to find too many assets could also exist under the Committee's “gatekeeping” version of the financial distress requirement if the recovered assets indicated that a debtor was actually not in financial distress on its petition date.
- 34 *Black's Law Dictionary* and the Bankruptcy Code do not include definitions for “financial distress.”
- 35 The court acknowledges that the priorities of the Bankruptcy Code would have to yield if financial distress was an element of constitutional subject matter jurisdiction.
- 36 [Keziah](#) is an example of this court not being sufficiently rigorous in its analysis of subject matter jurisdiction. [See also infra](#) ¶ 58. The reasoning of [Keziah](#) has been explicitly and convincingly rejected by the Fifth Circuit, [see Phillips](#), 844 F.2d at 235 n.2, and two years after [Keziah](#), the same judge, the Honorable Marvin R. Wooten, took a contrary jurisdictional position consistent with this order, [see Tatsis](#), 72 B.R. at 910 (“Filing of a case under Title 11 establishes jurisdiction in this Court in accordance with 28 U.S.C. §§ 1334 and 157. It gives the Court the right and authority to administer the case in accordance with the Bankruptcy Code.”).

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- 37 As mentioned previously *supra* ¶ 19, the LTL Opinion acknowledges that the good faith analysis is different in the Fourth Circuit and requires objective futility in addition to subjective bad faith. 64 F.4th at 98 n.8 (citing *Carolin*, 886 F.2d at 694); see also *Off. Comm. of Asbestos Claimants*, 71 F.4th at 182 (noting that the Fourth Circuit requires “a more comprehensive standard” to be met in order to dismiss a Chapter 11 case for a lack of good faith). The absence of financial distress ironically helps a debtor avoid a bad faith dismissal in this circuit. See *Bestwall*, 605 B.R. at 49–51 (finding that “Bestwall has the full ability to meet all of its obligations (whatever they may be) through its assets and New GP’s assets, which are available through the Funding Agreement” in the course of concluding that this case is not objectively futile and denying the First Motion to Dismiss without addressing subjective bad faith); *Aldrich*, 2023 WL 9016506, at *27 (observing that all bankruptcy cases filed by solvent debtors without financial distress will survive dismissal under the *Carolin* standard and wondering if the *Carolin* court considered the application of its test to such debtors); *33 (“Aldrich and Murray were designed to meet the objective futility standard, and they do.”). This case may provide a basis for the Fourth Circuit to reexamine its standard for good faith, at least in Texas Two-Step cases like this one, but it is not a basis to create a new jurisdictional requirement that could have “far-reaching consequences,” *Phillips*, 844 F.2d at 235 n.2.

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Remedy for Overcharge; Third-Party Releases; Standing to Object to a Plan; Discharge and Vicarious Fraud; Appeals of Orders Authorizing Sales; Tribal Immunity; the Uniformity Requirement; Equitable Mootness; Scope of the Automatic Stay; Tax Refund Allocation; Finality of Orders Denying Stay Relief; Appointments Clause; Effect of Rejection; Good Faith Violations of the Discharge Injunction; Standards of Appellate Review; Pass-Through Transfers; the Fraud Discharge Exception; and Structured Dismissals: *U.S. Trustee v. John Q. Hammons*; *Truck Insurance Exchange v. Kaiser Gypsum Co., Inc.*; *Harrington v. Purdue Pharma L.P.*; *Bartenwerfer v. Buckley*; *MOAC Mall Holdings LLC v. Transform Holdco LLC*; *Lac du Flambeau Bank of Lake Superior Chippewa Indians v. Coughlin*; *Siegel v. Fitzgerald*; *City of Chicago v. Fulton*; *Rodriguez v. FDIC*; *Ritzen Group, Inc. v. Jackson Masonry, LLC*; *Financial Oversight and Management Board for Puerto Rico v. Aurelius Investment, LLC*; *Mission Product Holdings, Inc. v. Tempnology, LLC*; *Taggart v. Lorenzen*; *U.S. Bank Nat'l Assoc. v. Village at Lakeridge*; *Merit Management Group LP v. FTI Consulting, Inc.*; *Lamar, Archer & Cofrin, LLP. v. Appling*; and *Czyzewski v. Jevic Holding Corp.*

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During the 2023-2024 term, the Supreme Court decided *U.S. Trustee v. John Q. Hammons*, no. 22-1238 (2024), a case involving the proper remedy for the unconstitutional assessment of fees as determined in *Siegel v. Fitzgerald*, no. 21-441 (2022); *Truck Insurance Exchange v. Kaiser Gypsum Co., Inc.*, no. 22-1079 (2024), a case involving standing to object to a Chapter 11 plan of reorganization; and *Harrington v. Purdue Pharma L.P.*, no. 23-124 (2024), a case involving third-party releases. During the 2022-2023 term, the Supreme Court decided *Bartenwerfer v. Buckley*, no. 21-908 (2023), a case involving the dischargeability of a liability for vicarious fraud; *MOAC Mall Holdings LLC v. Transform Holdco LLC*, no. 21-1270 (2023), a case involving appeals of orders authorizing sales in bankruptcy; and *Lac du Flambeau Bank of Lake Superior Chippewa Indians v. Coughlin*, no. 22-227 (2023), a case involving tribal sovereign immunity from the reach of the automatic stay. During the 2021-2022 term, the Supreme Court decided *Siegel v. Fitzgerald*, no. 21-441 (2022), a case involving the scope of the Uniformity Requirement of the Bankruptcy

Clause. During the term, the Court was asked multiple times to review the doctrine of Equitable Mootness, which (once again) it declined to take up. During the 2020-2021 term, the Supreme Court decided *City of Chicago v. Fulton*, 141 S. Ct. 585 (2021), addressing a profound circuit split over whether the automatic stay applies to so-called “passive” creditor conduct. During the 2019-2020 term, the Supreme Court decided *Rodriguez v. FDIC*, 140 S. Ct. 713 (2020), addressing whether, in determining how to allocate a tax refund among affiliated corporations, federal courts properly look to state law or federal common law; *Ritzen Group, Inc. v. Jackson Masonry, LLC*, 140 S. Ct. 582 (2020), addressing whether a bankruptcy court’s order denying relief from stay is final for appellate purposes; and *Financial Oversight and Management Board for Puerto Rico v. Aurelius Investment, LLC*, 139 S. Ct. 2735 (2020), addressing whether the appointment of the members of the oversight board overseeing the restructuring of Puerto Rico’s finances violated the Appointments Clause of the federal Constitution. During the 2018-2019 term, the Supreme Court decided *Mission Product Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652 (2019), addressing the effect of rejection in bankruptcy; and *Taggart v. Lorenzen*, 139 S. Ct. 1795 (2019), addressing good faith violations of the bankruptcy discharge. During the 2017-2018 term, the Supreme Court decided *U.S. Bank Nat’l Assoc. v. Village at Lakeridge*, 138 S. Ct. 960 (2018), addressing appellate standards of review; *Merit Management Group LP v. FTI Consulting, Inc.*, 138 S. Ct. 883 (2018), addressing the avoidability of pass-through transfers; and *Lamar, Archer & Cofrin, LLP. v. Appling*, 138 S. Ct. 1752 (2018), addressing the fraud discharge exception. During the 2016-2017 term, the Supreme Court decided *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017), addressing structured dismissals in Chapter 11 cases. This paper examines these issues and decisions.

A. *Hammons* and the Proper Remedy for an Unconstitutional Assessment

In *Seigel v. Fitzgerald*, no. 21-441 (2022) (discussed below), the Supreme Court addressed the different fee structure applicable to Chapter 11 debtors in different districts, concluding that the different fees violated the Uniformity Clause of the Bankruptcy Clause of the Constitution. The Court reasoned that, although Congress has broad authority to craft bankruptcy laws, including the ability to treat different classes of debtors differently, it could not “arbitrarily” burden “only one set of debtors with a more onerous funding mechanism than that which applies to debtors in other States.” Citing principally its prior decisions in *Hanover Nat. Bank v. Moyses*, 186 U.S. 181 (1902) and *Railway Labor Executives’ Assn. v. Gibbons*, 455 U.S. 457 (1982), the Court stated that “our precedent provides that the Bankruptcy Clause offers Congress flexibility, but does not permit the arbitrary, disparate treatment of similarly situated debtors based on geography.” The Court remanded to the Fourth Circuit to consider an appropriate remedy.

A number of Courts of Appeals then considered the issue remanded to the Fourth Circuit, with the consensus view being that the appropriate remedy is to give a refund to debtors charged more in the higher fee districts. The Supreme Court granted certiorari in a decision from the Tenth Circuit. Oral argument was heard on January 9, 2024. The Court issued its decision on June 14, 2024, reversing the Tenth Circuit.

As the Court framed the matter, it faced three choices: (a) direct a refund of fees to the extent debtors in some districts (the U.S. Trustee Districts) were required to pay more than debtors in other districts (the Bankruptcy Administrator Districts, located in Alabama and North Carolina); (b) direct the retroactive collection of more fees from debtors that paid less (*i.e.*, in the Bankruptcy Administrator Districts) so as to equalize the payments; or (c) require parity going forward. Reasoning that the nature of the violation determines the scope of the remedy, and viewing the

relevant analytical exercise as imagining what Congress would have wanted, the Court selected the third option.

The Court based its selection on several considerations. First, it observed that paying a refund would cost taxpayers approximately \$326 million. Second, it observed that the constitutional violation (*i.e.*, the non-uniformity of the disparate fee structures) was short-lived, occurring only between 2018 and 2021. Third, it determined that the disparity was small in scope, occurring in only a relatively small number of Chapter 11 cases. Fourth, it perceived that Congress' objective in charging the higher fees in question in the U.S. Trustee Districts was to make the U.S. Trustee program self-supporting, which would be undermined if refunds were granted. Fifth, the Court perceived that Congress had expressed a preference for the higher fee structure in the U.S. Trustee Districts, rendering a refund at odds with that preference. Sixth, when it amended the fee structure in 2021, Congress elected not to retroactively impose higher fees in the Bankruptcy Administrator Districts, signaling a preference for not imposing such a remedy. Seventh, the Court observed the existence of significant logistical problems associated with tracking down former debtors in the Bankruptcy Administrator Districts and attempting to collect more fees from them. Finally, the Court reasoned that considerations of due process did not require any particular remedy, as the debtors in the U.S. Trustee Districts had an opportunity to challenge their fees before paying them. All told, the Court concluded that these considerations counseled in favor of the remedy of requiring parity between the districts, which parity has already been in place since 2021.

B. Truck Insurance and Standing to Object to a Plan

Section 1109(b) provides that “[a] party in interest, including the debtor, the trustee, a creditors’ committee, an equity security holders’ committee, a creditor, an equity security holder, or an indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter.” The question is how far does this provision extend; specifically, does it permit an insurer to challenge a Chapter 11 plan when the insurer’s claim as a creditor for unpaid deductibles is rendered unimpaired and its treatment as an insurer is “insurance-neutral” as determined by the bankruptcy court.

The debtor’s Chapter 11 plan created a trust under section 524(g) to deal with its asbestos liabilities, the principal asset of the trust being the insurer’s policy. Claims covered by the insurance were to be litigated in the tort system. Claims not covered by insurance were to be paid by the trust, but apparently there were no non-covered claims. The claims covered by insurance remained subject to the insurers’ coverage defenses. Unsecured creditors were to be paid in full. The only party that objected to the plan was the insurer, claiming bad faith and that the plan was not insurance-neutral. Asbestos claimants voted unanimously in favor of the plan. The bankruptcy court concluded that the plan was insurance-neutral and confirmed the plan.

On appeal, the Fourth Circuit distinguished statutory standing under section 1109(b) and constitutional standing under Art. III. In order to have constitutional standing, a party must show (1) an injury in fact that is concrete, particularized, and actual or imminent; (2) an injury fairly traceable to the defendant’s conduct; and (3) an injury that can be addressed by a favorable decision. The Fourth Circuit ruled that the insurer had no constitutional standing to challenge the plan in its capacity as a creditor because its claims as a creditor were being rendered unimpaired—thus, no injury in fact. The court also ruled that, although the insurer had constitutional standing to challenge the finding of insurance neutrality, it lacked standing under section 1109(b) because

the plan was, in fact, insurance-neutral. The court also determined that a creditor found by the bankruptcy court to lack standing does have standing to appeal that determination.

On October 13, 2023, the Supreme Court granted certiorari, ostensibly to resolve a split of authority among the Courts of Appeals whether standing conferred under section 1109(b) is co-extensive with standing under Article III—an issue that has divided the courts. And on June 6, 2024, the Supreme Court reversed the Fourth Circuit.

As the Supreme Court observed, the Fourth Circuit determined that the insurance company was not a party in interest on the theory that the plan did not increase its obligations or impair its rights with respect to its policy. In rejecting this conclusion, the Court reasoned that analyzing the question in this way improperly “conflates the merits of an objection with the threshold party in interest inquiry.” Instead, “the § 1109 inquiry asks whether the reorganization proceedings might affect a prospective party, not how a particular reorganization plan actually affects that party.” The Court explained that section 1109(b) cannot depend on how the party is ultimately treated because the function of the provision is to permit participation in the case before the ultimate question is resolved one way or the other. The Court supported its reasoning by reference to the capacious text of the provision, the context in which it appears, its participatory purpose, and its history. The Court added that, although section 1109(b) provides generally for a broad right of participation, “[c]ourts must determine on a case-by-case basis whether a prospective party has a sufficient stake in [the] reorganization proceedings to be a ‘party in interest.’”

C. Purdue and Third-party Releases

The Bankruptcy Code provides that, in addition to various enumerated requirements, a Chapter 11 plan may include “any other appropriate provision not inconsistent with the applicable provisions of this title.” 11 U.S.C. § 1123(b)(6). The question presented in the *Purdue* case is whether this provision, together with other provisions of the Code, permit the confirmation of a Chapter 11 plan that release third-parties who contribute to the plan from liabilities owed to the debtor’s creditors.

Purdue was a privately held company. Mortimer and Raymond Sackler purchased Purdue’s predecessor in 1952, and members of the Sackler family held positions as directors and officers at Purdue for decades. During this period, Purdue developed OxyContin, an opioid analgesic. As OxyContin use increased, so did abuse of the drug.

In 2001, Purdue began facing product-liability lawsuits. Years after those initial cases were resolved, Purdue, beginning around 2017, faced a second wave of litigation seeking to hold Purdue liable for the opioid crisis. Many of these suits also named the Sacklers and related entities as defendants, alleging that they were responsible for Purdue’s tortious acts or that Purdue was their alter ego.

Between 2008 and 2017, Purdue distributed \$10.4 billion to trusts benefitting the Sacklers. Of that, \$4.6 billion was distributed for taxes owed on the income generated by Purdue. A large amount of the non-tax distributions were made to spendthrift trusts, created as far back as 1974, “that could not be reached in bankruptcy,” as well as in “off-shore entities located in places like the Bailiwick of Jersey.” By 2019, “all Sacklers had stepped down from Purdue’s Board.” Since then, no Sackler has been involved in running Purdue.

In September 2019, Purdue and certain affiliates (collectively, “the Debtors”) filed for Chapter 11 reorganization. The U.S. Trustee appointed an Official Committee of Unsecured

Creditors to represent the interests of all unsecured creditors. Multiple ad hoc creditors' groups were also formed by personal-injury victims; state, local, and other governmental entities; and other constituencies.

Over the next two years, the Debtors and the various creditor groups and constituencies worked toward a negotiated resolution. During this process, there was "extensive discovery," including the production of "tens of millions of documents." This process culminated in a series of interlocking agreements dependent on a multibillion-dollar settlement reached with the Sacklers. As part of this process, Purdue and its creditors settled civil claims against the Sacklers, pursuant to which settlements the Sacklers agreed to contribute up to \$6 billion to the estates in exchange for certain negotiated releases incorporated into the Debtors' plan.

Specifically, sections 10.7(a) and 10.7(c) of the plan release the Sacklers from claims held by the Debtors and their estates, and vice-versa. Section 10.7(b)—the "third-party release" provision at issue—releases the Sacklers from certain claims held by the Debtors' creditors, "including any derivative claims asserted or assertible . . . on behalf of the Debtors or their Estates," as well as claims that the Debtors' creditors could "assert in [their] own right" insofar as they relate to the "Debtors' Opioid-Related Activities." The releases do not "adjudicat[e]" these claims. Rather, an injunction channels them to creditor trusts for resolution under detailed procedures.

While the releases cover an array of opioid-related claims held by creditors, including claims for fraud, they are limited in several respects. In particular, they encompass only claims for which the "conduct, omission or liability of any Debtor or any Estate is the legal cause or is otherwise a legally relevant factor." Thus, "[t]he third-party claims that the plan would release and enjoin are very closely related on the facts to the estates' claims for alter ego, veil piercing,

and breach of fiduciary duty/failure to supervise” that were settled under the plan. Any third-party claims against the Sacklers that are (a) not held by a creditor of the Debtors, (b) not opioid-related, or (c) opioid-related but *not* dependent on the Debtors’ conduct (e.g., “a claim against one of the Sacklers, some of whom are doctors, for negligently prescribing OxyContin”), are not subject to the releases. The releases exclude all claims based on post-bankruptcy conduct, governmental claims for criminal or tax liability, and claims by the United States.

The bankruptcy court confirmed the plan after conducting a six-day trial. After examining the releases, the bankruptcy court required that Section 10.7(b) be “modified to state that a Debtor’s conduct, or a claim asserted against a Debtor, must be a legal cause of the released claim, or a legally relevant factor to the third-party cause of action against the [Sacklers].” Due to this “causal legal dependence on [a] Debtor’s conduct,” the court found that the claims subject to the releases would “directly affect the *res* of the Debtors’ estates, including insurance rights, the [Sacklers’] rights to indemnification and contribution, and the Debtors’ ability to pursue the estates’ own closely related, indeed fundamentally overlapping, claims.”

The bankruptcy court also found that the releases were necessary to the reorganization and in the “best interests of” creditors. It further found that the plan would likely “unravel” without the releases, forcing the Debtors into a Chapter 7 liquidation in which opioid victims and other tort claimants would “most likely” recover nothing from the estates. As part of that analysis, the court concluded that, even if claimants obtained a favorable judgment against the Sacklers, they would face “serious collection issues” since the Sacklers “are a large family,” many of them “live outside the territorial jurisdiction of the United States,” and their assets are “widely scattered” and held in “offshore trusts.” Ultimately, the court found that “the Sacklers are paying a substantial and, under the circumstances of this case, justifiable amount.”

Applying Second Circuit and other precedent, the bankruptcy court concluded that sections 1123(b)(3)(A) and (b)(6) of the Code authorized the releases as narrowed. It explained that those provisions permit resolution of the Debtors’ “enormous claims” against the Sacklers, as well as the “very closely related claims that are separately asserted by third parties who are also creditors of the Debtors.” Whether the released claims are “derivative” or “direct,” the court held that it is the substantive “effect” of the claims on the estates that matters. And, here, the court found, all the released claims “directly affect the *res* of the Debtors’ estates,” and the reorganization would be impossible without resolving them.

On appeal, the district court reversed, concluding that, because the Bankruptcy Code does not specifically refer to nonconsensual third-party releases outside the asbestos context, it does not authorize the releases at issue here. Recognizing that its resolution of the issue was contestable and warranted immediate review, however, the district court granted permission to file an interlocutory appeal to the Second Circuit.

On interlocutory review, the Second Circuit reversed the district court. It held that the authority to approve third-party releases “is rooted” in sections 105(a) and 1123(b)(6). As the court explained, “§ 1123(b)(6) permits the inclusion of ‘any other appropriate provision’ in a plan so long as it is ‘not inconsistent’ with other sections of the Bankruptcy Code.” In construing section 1123(b)(6), the court looked to *United States v. Energy Resources Co.*, 495 U.S. 545, 549 (1990), in which the Supreme Court held that section 1123(b)(6) confers a broad “residual authority” to approve appropriate plan provisions that is limited only “by what the Code expressly forbids, not what the Code explicitly allows.” After considering sections 524(e) and (g), the Second Circuit concluded that it could discern “no reason grounded in the text of the Bankruptcy Code to bar the inclusion of third-party releases in plans of reorganization.”

The Second Circuit also stressed that courts must carefully review such releases to ensure they are warranted in the circumstances. The court identified several factors to guide this determination, against the “backdrop of equity.” Applying them, the court stressed that the released claims here are “factually and legally intertwined” with the conduct of the Debtors and “directly affect the *res*.” Without the releases, the court explained, “the Debtors would, in all likelihood, be required to litigate indemnity and contribution claims brought against them by the Sacklers, which would likely deplete the *res*, no matter the outcome of those claims.” The court thus concluded that “the [r]eleases are both needed for the distribution of the *res* and to ensure the fair distribution of any recovery for claimants.”

On August 10, 2023, the Supreme Court stayed the Debtors’ plan and granted certiorari review. Argument was conducted on December 4, 2023. On June 27, 2024, the Supreme Court in turn reversed the Second Circuit.

In rendering its decision, the Supreme Court commenced its analysis with an observation: as generally understood, a debtor “can win a discharge of its debts if it proceeds honestly and places virtually all of its assets on the table for its creditors.” Observing that while both the Debtors and the Sackler family faced a multitude of lawsuits stemming from the opioid crisis, only the Debtors had filed for bankruptcy relief; the Sacklers, in contrast, “chose a different path.” As the Court saw things, the Sacklers “sought and won” from the bankruptcy court “an order extinguishing vast numbers of existing and potential claims against them,” all “without securing the consent of those affected or placing anything approaching their total assets on the table for their creditors.” The Court concluded that the Bankruptcy Code does not authorize such relief.

First, the Court observed that, under section 1141, a Chapter 11 debtor may obtain a discharge of its debts, except as provided under the Code. Generally speaking, “a discharge

operates only for the benefit of the debtor and against its creditors and ‘does not affect the liability of any other entity.’” 11 U.S.C. § 524(e). Observing again that the Sacklers have not filed for bankruptcy and have not “placed virtually all of their assets on the table for distribution to creditors,” the Court concluded that, what they were seeking was, in essence, “a discharge” of their obligations. The question became whether some other provision of the Code authorized this result.

To answer this question, the Court looked to section 1123. The Court observed that section 1123 authorizes a number of plan provisions, including those that provide for the settlement of claims, the sale of assets, and, in section 1123(b)(6), “any other appropriate provision not inconsistent with the applicable provisions of this title.” After ruling out the provisions of section 1123 that permit a plan to address claims and property belonging to the debtor and modify the rights of creditors holding claims against the debtor or its bankruptcy estate (*i.e.*, sections 1123(b)(1)-(5)), the Court considered whether the broad language of section 1123(b)(6) was capacious enough to authorize the relief granted to the Sacklers. The Court conclude that it is not for several reasons.

To begin with, the Court rejected the construction of section 1123(b)(6) that it broadly permits a term not expressly forbidden so long as the bankruptcy judge “deems it ‘appropriate’ and consistent with the broad ‘purpose[s]’ of bankruptcy.” The Court reasoned that section 1123(b)(6) is a catchall provision preceded by a list of specific authorizations. Applying the *ejusdem generis* canon, the Court concluded that the scope of section 1123(b)(6) is properly cabined by reference to the more specific authorizations it follows. What the more specific authorizations share in common, the Court reasoned, what that they all “concern the debtor—its rights and responsibilities, and its relationship with its creditors.”

Conceding that section 1123(b)(6) conferred additional authority not found in sections 1123(b)(1)-(5), nonetheless the Court determined that this additional authority must be tethered to the debtor and its property and liabilities, not the liabilities of third parties. In the Court's view, this did not include discharging the debts of non-debtors, such as the Sacklers.

As the Court noted, this does not mean that a debtor cannot provide for the settlement of claims, including derivative claims against non-debtors. What it does mean is that the settled claims must be those belonging to the debtor's estate. The problem with the Debtors' plan was that it sought "to extinguish claims against the Sacklers that belong to their victims." The Court reasoned that "precisely nothing in § 1123(b) suggests those claims can be bargained away without the consent of those affected, as if the claims were somehow Purdue's property."

The Court next considered the purposes of the Bankruptcy Code, including resolving collective-action problems occasioned by the debtor's insolvency. Conceding implicitly that the problem addressed in *Purdue* was indeed a collective-action challenge, the Court nonetheless considered whether it was one Congress had elected to address within its remedial scheme. The Court concluded that it has not—at least not to the extent of extending the relief at issue to the Sacklers.

Turning to statutory context, the Court next analyzed other provisions of the Code for clues regarding the scope of section 1123(b)(6). First, the Court observed once again that discharges are generally available only to debtors who have filed for bankruptcy themselves, which the Sacklers have not done. Second, the Court noted that, in order to obtain a discharge, the debtor must typically "come forward with virtually of its assets," which the Sacklers also have not done. Third, the Court observed that, although Congress created a notable exception to the general scope of the discharge for asbestos-related bankruptcies, Congress has not done so in other contexts.

According to the Court, this “makes it all the more unlikely that § 1123(b)(6) is best read to afford courts the same authority in *every* context.”

Finally, the Court considered the history behind the Bankruptcy Code. Recognizing that pre-Code practice may properly inform the meaning of the Code’s provisions, the Court found no expansive pre-Code practice that supported granting the relief afforded to the Sacklers in the matter. Turning to considerations of policy, the Court noted that there may well be valid policy arguments on both sides. “But, in the end,” the Court observed, “we are the wrong audience for them.” Rather, that is a job for Congress.

In conclusion, the Court emphasized what it was not deciding. In particular, it was not deciding the propriety of “*consensual* third-party releases offered in connection with a bankruptcy reorganization plan” because “those sorts of releases pose different questions and may rest on different legal grounds than the nonconsensual release at issue here.” The Court also remarked: “Nor do we have occasion today to 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.” The Court also added that “we do not address whether our reading of the bankruptcy code would justify unwinding reorganization plans that have already become effective and have been substantially consummated.” The Court concluded that “we hold only 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 affected claimants.”

D. Bartenwerfer and the Dischargeability of Liability for Vicarious Fraud

Section 523(a)(2)(A) of the Bankruptcy Code excepts from discharge any debt “for money [or] property . . . to the extent obtained by . . . false pretenses, a false representation, or actual fraud” This provision has long been understood to exclude from discharge a debtor’s liability for the debtor’s own fraud. But what if the fraud was committed by another person and the debtor is only vicariously liable under applicable state law because the debtor was a partner in a venture with the other person and received some benefit from the fraudulent conduct? In *Bartenwerfer v. Buckley*, the Court concluded that section 523(a)(2)(A) applies to that as well.

In 2005, the debtor (Kate) and her then-boyfriend and later-husband (David) purchased a house in San Francisco as business partners. David handled the renovations; Kate was largely uninvolved. The house was subsequently sold to respondent (Buckley).

As part of the sale, Kate and David attested that they had disclosed all material facts relating to the property. After purchasing the property, however, Buckley discovered defects that he claimed had not been disclosed, including a leaky roof, a missing fire escape, defective windows, and permit problems. Claiming that he had overpaid for the property, Buckley sued David and Kate in state court and obtained a judgment for \$200,000, which the couple could not pay.

After the couple filed for Chapter 7 bankruptcy relief, Buckley filed a complaint seeking to have the debt excepted from discharge. After a short trial, the bankruptcy court determined that David had knowingly concealed the defects from Buckley, and imputed David’s fraudulent intent to Kate because the two had formed a partnership to conduct the renovations and resell the house. On appeal, the Bankruptcy Appellate Panel reversed on the theory that Kate could be liable only if she knew or had reason to know of David’s fraud. On remand, the bankruptcy court concluded that Kate lacked the requisite knowledge and therefore could discharge the debt. Thereafter, the

Bankruptcy Appellate Panel affirmed, but the Ninth Circuit reversed in relevant part, citing *Strang v. Bradner*, 114 U.S. 555 (1885), which held that a debtor cannot discharge a debt for a partner’s fraud. On further review, the Supreme Court affirmed.

The Court began its analysis with the observation that the liability in question appeared to fall squarely within the terms of the provision: Kate was a debtor; the fraud judgment was a debt; and the liability arose from David’s fraudulent misrepresentations, therefore constituting a debt “for money . . . obtained by . . . false pretenses, a false representation, or actual fraud.” Notably, the provision “obtained by” is drafted in the passive voice without specifying *by whom*. Kate argued that the provision is best read to mean “obtained by” the fraud “*of the debtor*,” not someone else. Rejecting this reading, the Court concluded instead that “[t]he debt must result from someone’s fraud, but Congress was ‘agnosti[c]’ about who committed it.” Thus, the debtor could be saddled with a non-dischargeable debt for someone else’s fraud, so long as the debtor also owed the debt.

Turning to context, Kate observed that section 523(a)(2)(A)’s neighboring provisions, subsections (2)(B) and (2)(C), both require action by the debtor, not someone else. She argued that section 523(a)(2)(A) should be construed in a manner consistent with these companion provisions and likewise be understood to involve on the culpable conduct of the debtor. The Court disagreed, citing instead the canon that differences in language should be taken as deliberate legislative choices—the absence of a reference to the debtor’s conduct in section 523(a)(2)(A) meant that it was not limited to culpable activity by the debtor.

The Court then turned to the history behind section 523(a)(2)(A), and in particular the Court’s prior decision in *Strang v. Bradner*, 114 U.S. 555 (1885), which denied a discharge to two individuals for the fraud perpetrated by their business partner. The relevant statute at the time

excepted discharge for liability for fraud “of the bankrupt.” Nonetheless, the Court in *Strang* construed the statute to deny discharge relief to others who did not themselves commit fraud, but received a benefit from the fraudulent conduct of their partner. The Court observed that, after *Strang*, Congress dropped the phrase “of the bankrupt” in the immediate statutory predecessor to section 523(a)(2)(A), suggesting (according to the Court) that Congress approved the Court’s interpretation. Applying the principle that, in reenacting a statutory provision Congress intends established judicial interpretations to follow along with it, the Court determined that Congress had embraced *Strang*.

Although the Court addressed several policy arguments, absent from the Court’s analysis is consideration of the traditionally understood purpose of the discharge (at least in its traditional formulation): namely, to give the honest but unfortunate debtor a fresh start. Kate would seem to fit the bill. Given that exceptions to the discharge are typically construed narrowly to promote this policy, Kate argued that the more appropriate reading of the statute would be that it applies only to debts for fraud *by the debtor*. Nonetheless, the Court concluded that “innocent people are sometimes held liable for fraud they did not personally commit, and, if they declare bankruptcy, § 523(a)(2)(A) bars discharge of that debt.”

E. MOAC and the Appealability of Orders Authorizing Bankruptcy Sales

Section 363 of the Bankruptcy Code authorizes bankruptcy sales, with court approval if out of the ordinary course of the debtor’s business. In turn, section 363(m) directs: “[t]he reversal or modification on appeal of an authorization . . . of a sale or lease of property does not affect the validity of a sale or lease [to a good-faith purchaser] unless such authorization and such sale or lease were stayed pending appeal.” If the bankruptcy court approves a sale to a good faith

purchaser and the sale closes without an objector obtaining a stay, does an appellate court have the authority to proceed with an appeal seeking to undo the sale given that the statute directs that reversal or modification of the order approving the sale does not affect the validity of the sale?

On May 30, 1991, Sears entered into an agreement to construct and operate a retail store at the Mall of America (MOAC). Sears constructed the building in question, leasing the underlying real estate under a ground lease. The terms of the lease were highly favorable to Sears: its rent was a mere \$10 a year for 100 years. In addition, Sears was required to operate its retail department store for only the first 15 years of the lease. Thereafter, the lease was freely assignable.

After Sears commenced its Chapter 11 case in 2018, the bankruptcy court entered an order under section 363(b)(1) authorizing the sale of substantially all of Sears' assets to respondent Transform in accordance with the parties' asset purchase agreement. As a significant portion of Sears' assets were long-term leases of real property where its stores were located, much of the value that Transform purchased was its right to designate leases for Sears to assume and assign to it.

After Transform designated the lease in question for assumption and transfer, the bankruptcy court held a hearing and, over MOAC's objection, approved the assumption and transfer to Transform. After the bankruptcy court denied MOAC's request for a stay, Sears and Transform closed their transaction and Transform thus became the owner of the building together with the relevant ground lease as part of the sales transaction. Although MOAC appealed the bankruptcy court's order, it did not seek a further stay.

Ultimately, the Second Circuit concluded that it lacked jurisdiction under section 363(m) to entertain MOAC's appeal seeking to overturn the transfer of the building and ground lease, and it therefore dismissed the appeal. Thereafter, the Supreme Court granted MOAC's petition for a

writ of certiorari. The matter was argued on December 5, 2022 and, on April 23, 2023 the Supreme Court reversed the Second Circuit, concluding that section 363(m) is not a jurisdictional provision.

In reaching its conclusion, the Court emphasized that it is for Congress to establish the jurisdiction of the lower federal courts, which entails regulation of “the power of the court” to hear a particular matter, as opposed to provisions bearing on “the rights or obligations of the parties.” In order to differentiate between jurisdictional and other regulations, the Court stated that it will only treat a provision as jurisdictional if Congress “clearly states” as much. Although this clear-statement rule does not require Congress to use “magic words,” Congress’ designation must be clear and not merely “plausible” or “better than” other alternatives. The Court found that section 363(m) did not meet this standard, and so is not jurisdictional.

F. Lac du Flambeau and Tribal Immunity

A bankruptcy filing ordinarily triggers the “automatic stay”—a statutory injunction “applicable to all entities” that bars, among other things, “any act to obtain possession of property of the estate . . . [and] any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case” The automatic stay is essential to the sound functioning of the bankruptcy process. *See* H.R. Rep. No. 95-595, at 340-41 (1977). With certain exceptions, it is the primary means of protecting the debtor and estate property; the competing rights of creditors; the bankruptcy court’s exclusive jurisdiction over the administration of the case; and the debtor’s ultimate entitlement to relief from unmanageable indebtedness. *City of Chicago, Ill. v. Fulton*, 141 S. Ct. 585, 589 (2021) (“The automatic stay serves the debtor’s interests by protecting the estate from dismemberment, and it also benefits creditors as a group by

preventing individual creditors from pursuing their own interests to the detriment of the others.”); S. Rep. No. 95-989, at 55 (1978); 11 U.S.C. § 362(k) (authorizing relief for violations of the stay).

In July 2019, Brian Coughlin took out a \$1,100 “payday” loan from Lendgreen, a payday lender affiliated with the Lac du Flambeau Band of Lake Superior Chippewa Indians (the “Band”). Coughlin thereafter filed for bankruptcy relief. Notwithstanding Coughlin’s bankruptcy filing (of which Lendgreen was aware), and in direct violation of the automatic stay, 11 U.S.C. § 362(a), Lendgreen continued to call Coughlin, seeking repeatedly to collect payment of the debt. Lendgreen’s harassment “compounded” the effects of Coughlin’s financial distress, and his “mental and financial agony” led him to “attempt[] suicide.” Nonetheless, Lendgreen persisted in calling him both in the hospital and after his release.

Thereafter, Coughlin moved to enforce the automatic stay. The Band asserted tribal immunity. The bankruptcy court ruled in the Band’s favor, concluding that, although the Bankruptcy Code contains “a broad abrogation of sovereign immunity” in section 106, it would follow the Sixth Circuit’s decision in *In re Greektown Holdings, LLC*, 917 F.3d 451 (6th Cir. 2019), holding that “‘§§ 106 [and] 101(27) lack the requisite clarity of intent to abrogate tribal sovereign immunity.’” On further appeal, the First Circuit reversed, deepening a circuit split on whether section 106 abrogates tribal immunity in bankruptcy cases.

Payday lenders like Lendgreen have systematically sought shelter within the umbrella of tribal immunity to evade enforcement of the Bankruptcy Code. *See Michigan v. Bay Mills Indian Community*, 572 U.S. 782, 825 (Thomas, J., dissenting) (“[P]ayday lenders . . . often arrange to share fees or profits with tribes so they can use tribal immunity as a shield for conduct of questionable legality.”). On January 13, 2023, the Supreme Court granted certiorari; the case was argued on April 24, 2023; and, on June 15, 2023, the Court affirmed the First Circuit.

In reaching its decision, the Court held that section 106 unambiguously abrogates the sovereign immunity of all governments, including federally recognized Indian tribes. The Court reasoned that section 106(a) expressly abrogates the sovereign immunity of “governmental units” under various provisions of the Code, including section 362. In turn, section 101(27) defines “governmental unit” broadly as the United States, a State, a Commonwealth, a District, a Territory, a municipality, a foreign state, a department, agency, or instrumentality of these entities, and other foreign or domestic governments. Although Congress must make its intentions clear to abrogate Tribal immunity, Congress did so in these provisions because they unambiguously include Indian tribes.

It is not necessary, the Court stated, for Congress to specifically mention “Indian tribes” in the statutory text. Given that Indian tribes are indisputably “governments,” Congress’ broad and all-encompassing language was sufficient.

G. Siegel and the Uniformity Requirement of the Bankruptcy Clause

The Bankruptcy Clause authorizes Congress to enact “uniform laws” on the subject of bankruptcies. U.S. Const. art. I, § 8, cl. 4. A question that has divided the circuit courts is whether the Chapter 11 fees charged in districts supervised by the United States Trustee program, as compared to the different fees charged in districts supervised by the Bankruptcy Administrator Program, violate the Uniformity Requirement. Two circuits held that it does, and three held that it does not. *See United States Trustee Region 21 v. Bast Amron LLP (In re Mosaic Mgmt. Grp., Inc.)*, 22 F.4th 1291 (11th Cir. 2022)(no); *In re Clinton Nurseries, Inc.*, 998 F.3d 56 (2d Cir. 2021) (yes); *Seigel v. Fitzgerald (In re Circuit City Stores, Inc.)*, 996 F.3d 156 (4th Cir. 2021) (no); *Mater*

of Buffets, L.L.C., 979 F.3d 366 (5th Cir. 2020) (no); *In re John Q. Hammons Fall 2006, LLC*, no. 20-3203 (10th Cir. October 5, 2021) (yes).

The federal judiciary is divided into ninety-four judicial districts, most of which have a bankruptcy court (the Eastern and Western Districts of Arkansas share a bankruptcy court; the judicial districts for the Virgin Islands, Northern Mariana Islands, and Guam do not have bankruptcy courts). The Department of Justice, through the U.S. Trustee Program, supervises bankruptcy proceedings in eighty-eight of these districts. The Judicial Conference, through its Bankruptcy Administrator Program, supervises six districts located in Alabama and North Carolina.

The two systems are funded in different ways. The Bankruptcy Administrator Program is funded from the general judicial budget supervised by the Judicial Conference. The U.S. Trustee Program is funded from the budget supervised by the Department of Justice funded from fees that debtors pay. As is relevant to the controversy, Chapter 11 debtors pay quarterly disbursement fees based on the size of the quarterly disbursements they make to creditors. At first, Congress imposed these fees only in the districts supervised by the United States Trustee Program. In 1994, however, the Ninth Circuit ruled that imposing a different and more costly system on debtors everywhere but in Alabama and North Carolina violated the Uniformity Requirement. *See St. Angelo v. Victoria Farms, Inc.*, 38 F.3d 1525 (9th Cir. 1994). In response, Congress allowed the Judicial Conference to charge fees in districts supervised by the Bankruptcy Administrator Program equivalent to those charged in all the other districts.

For many years, the fees charged in the different districts were the same. In 2017, however, Congress mandated increased quarterly Chapter 11 disbursement fees for large debtors in districts supervised by the U.S. Trustee Program. These changes were designed to cover shortfalls in

funding for the program. This raised the fees from a maximum of \$30,000 to the lesser of either \$250,000 or one percent of the quarterly disbursements. Beginning on and after January 1, 2018, the fees increased accordingly for all large Chapter 11 debtors in districts supervised by the U.S. Trustee Program, even if these debtors' cases were already pending. Large Chapter 11 debtors in districts supervised by the Bankruptcy Administrator Program were charged less. First, the Judicial Conference did not increase the quarterly fees for these debtors until October of 2018, and, second, the increase did not apply to pending cases. Thus, in districts supervised by the Bankruptcy Administrator Program, large Chapter 11 debtors with cases pending before October of 2018 incurred no increased fees regardless of how long their cases remained pending.

As noted, two courts of appeals concluded that this disparate system violates the Uniformity Requirement; three have concluded that it does not. The Court granted certiorari in the Fourth Circuit case (*Seigel v. Fitzgerald*, no. 21-441) on January 10, 2022, and on Jun 6, 2022 reversed, concluding that the disparate fee structure did indeed violate the Uniformity Clause. The Court reasoned that, although Congress has broad authority to craft bankruptcy laws, including the ability to treat different classes of debtors differently, it could not “arbitrarily” burden “only one set of debtors with a more onerous funding mechanism than that which applies to debtors in other States.” Citing principally its prior decisions in *Hanover Nat. Bank v. Moyses*, 186 U.S. 181 (1902) and *Railway Labor Executives' Assn. v. Gibbons*, 455 U.S. 457 (1982), the Court stated that “our precedent provides that the Bankruptcy Clause offers Congress flexibility, but does not permit the arbitrary, disparate treatment of similarly situated debtors based on geography.” The Court remanded to the Fourth Circuit to consider an appropriate remedy. The issue of the proper remedy is currently percolating in the lower courts and may end up back again the Supreme Court.

H. Equitable Mootness

Orders confirming Chapter 11 plans are characteristically final orders subject to immediate appellate review. In the absence of a stay pending appeal, however, debtors are generally free to substantially consummate their plans, including by transferring assets, borrowing funds, and making distributions to creditors. In some cases, appellate relief seeking to alter the treatment of a particular claim, the disposition of assets, the order confirming the plan, or other orders of the bankruptcy court, may be infeasible or inequitable owing to its effects on third parties. If so, the appellate court may deny relief under the court-created doctrine of “equitable mootness.” *See, e.g., In re Envirodyne Indus., Inc.*, 29 F.3d 301, 304 (7th Cir. 1994) (Posner, J.) (equitable mootness “is perhaps best described as merely an application of the age-old principle that in formulating equitable relief a court must consider the effects of the relief on innocent third parties.”); *see also Search Market Direct, Inc. v. Jubber (In re Paige)*, 584 F.3d 1327, 1335 (10th Cir. 2009) (“[T]he doctrine of equitable mootness is rooted, at least in part, in the court’s discretionary power to fashion a remedy in cases seeking equitable relief.”); *In re AOV Indus., Inc.*, 792 F.2d 1140, 1147–48 (D.C. Cir. 1986) (“[T]here exists ... a melange of doctrines relating to the court’s discretion in matters of remedy and judicial administration. Even when the moving party is not entitled to dismissal on [A]rticle III grounds, common sense or equitable considerations may justify a decision not to decide a case on the merits.”).

The doctrine traces its origins to *Trone v. Roberts Farms, Inc. (In re Roberts Farms, Inc.)*, 652 F.2d 793 (9th Cir. 1981). In that case, the bankruptcy court confirmed a plan of arrangement under Chapter XI of the Bankruptcy Act of 1898 over the objection of a creditor, Trone. After Trone appealed to the district court, the appellees moved to dismiss the appeal as moot. After the district court granted the motion, Trone appealed to the Court of Appeals for the Ninth Circuit. By

that time, the plan had been substantially consummated. In dismissing the appeal as moot, the Ninth Circuit reasoned as follows:

Here the many intricate and involved transactions ... were contemplated by the plan of arrangement (even to and including liquidation and reorganization of the debtor corporation) and stand solely upon the order confirming the plan of arrangement for court approval and confirmation of the transactions. Were we to deny the motion to dismiss for mootness and on consideration of the merits reverse the order of the District Court, what would be the result? 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.

652 F.2d at 797.

In 1996, the Third Circuit applied the doctrine in its *en banc* decision in *In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996) (*en banc*). In approving the doctrine, the court recognized that its application typically rests on the consideration of several factors:

Factors that have been considered by courts in determining whether it would be equitable or prudential to reach the merits of a bankruptcy appeal include (1) whether the reorganization plan has been substantially consummated, (2) whether a stay has been obtained, (3) whether the relief requested would affect the rights of parties not before the court, (4) whether the relief requested would affect the success of the plan, and (5) the public policy of affording finality to bankruptcy judgments.

Id., at 560. Dissenting from this decision, then-Judge Alito reasoned that the doctrine had been applied too broadly—well-beyond (in his view) any legitimate justification. *See id.*, at 570 (Alito, J., dissenting). Echoing then-Judge Alito’s view, the doctrine has been criticized more recently as an abrogation of the federal courts’ “virtually unflagging obligation” to hear appeals within their jurisdiction. *In re One2One Commc’ns, LLC*, 805 F.3d 428, 433 (3d Cir. 2015); *In re Charter Commc’ns, Inc.*, 691 F.3d 476, 481 (2d Cir. 2012). Under this line of reasoning, dismissing an appeal on equitable mootness grounds “should be the rare exception.” *In re Tribune Media Co.*, 799 F.3d 272, 288 (3d Cir. 2015); *In re Pac. Lumber Co.*, 584 F.3d 229,

240 (5th Cir. 2009) (the doctrine of equitable mootness should be applied “with a scalpel rather than an axe”).

Although every court of appeals has applied the doctrine in one form or another, there are differences in the particular tests they apply. *Compare R2 Investments, LDC v. Charter Communications, Inc.*, 691 F.3d 476, 481 (2d Cir. 2012) (reciting Second Circuit’s five-part test),¹ with *Samson Energy Resources Company v. Semcrude, L.P. (In re Semcrude, L.P.)*, 728 F.3d 314, 321 (3d Cir. 2013) (“it is useful to think of equitable mootness as proceeding in two analytical steps: (1) whether a confirmed plan has been substantially consummated; and (2) if so, whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation.). In addition, some courts have limited the doctrine to orders confirming Chapter 11 plans. *See, e.g., In re LCI Holding Company, Inc.*, 802 F.3d 547, 554 (3d Cir. 2015); *In re Sneed Shipbuilding, Inc.*, 916 F.3d 405, 409 (5th Cir. 2019). Others, including those in the Second, Fourth, Ninth, Tenth, and Eleventh

¹ The court explained: “In this circuit, an appeal is presumed equitably moot where the debtor’s plan of reorganization has been substantially consummated. . . . The presumption of equitable mootness can be overcome, however, if . . . five . . . factors are met:

- (1) ‘the court can still order some effective relief’;
- (2) ‘such relief will not affect the re-emergence of the debtor as a revitalized corporate entity’;
- (3) ‘such relief will not unravel intricate transactions so as to knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for the Bankruptcy Court’;
- (4) ‘the parties who would be adversely affected by the modification have notice of the appeal and an opportunity to participate in the proceedings’; and
- (5) ‘the appellant pursued with diligence all available remedies to obtain a stay of execution of the objectionable order if the failure to do so creates a situation rendering it inequitable to reverse the orders appealed from.’

Id., at 481 (quoting *Frito-Lay, Inc. v. LTV Steel Co. (In re Chateaugay Corp.)*, 10 F.3d 944, 952 53 (2d Cir. 1993)).

Circuits, have applied it more broadly. *See, e.g., In re Windstream Holdings, Inc.*, 838 Fed. App'x 634 (2d Cir. 2021) (dismissing as equitably moot an appeal of a “critical vendor” order directing the payment of the prepetition claims of vendors deemed essential to the success of a Chapter 11 debtor’s reorganization before the claims of other unsecured creditors following confirmation of the debtor’s Chapter 11 plan); *Myers v. Offit Kurman, P.A.*, 773 F. App'x 161, 162 (4th Cir. 2019) (dismissing as equitably moot an appeal from a bankruptcy court order granting a Chapter 7 trustee’s motion for approval of a settlement agreement where the agreement had been fully consummated and the funds had been distributed accordingly); *Stokes v. Gardner*, 483 F. App'x 345, 346 (9th Cir. 2012) (dismissing appeal of an order approving a settlement agreement in a Chapter 7 case as equitably moot); *Ordonez v. ABM Aviation, Inc.*, 787 F. App'x 533 (10th Cir. 2019) (dismissing as equitably moot debtor’s appeal from a bankruptcy court order relating to a Chapter 7 trustee’s settlement of the debtor’s employment discrimination claims where the debtor did not diligently seek a stay, the settlement agreement had been fully consummated, the funds had been distributed, the estate had been fully administered, and the debtor’s challenges were not compelling); *In re JMC Memphis, LLC*, 655 F. App'x 802 (11th Cir. 2016) (dismissing as equitably moot an appeal from an unstayed order approving a settlement between the Chapter 7 trustee and the debtor’s insurer).

In *In re Nuverra Environmental Solutions, Inc.*, 834 Fed. App'x 729 (3d Cir. 2021) (discussed [here](#)), a divided panel of the Third Circuit dismissed as equitably moot an appeal of a “gifting” Chapter 11 plan—one in which a senior class “gifts” a portion of its recovery to a junior class as a means of achieving a consensual confirmation, but the effect is unequal treatment among unsecured creditors or one that permits a subordinate class to be paid ahead of a class entitled to a higher priority. A creditor filed a petition for a writ of certiorari on July

6, 2021 seeking review of the doctrine, which the Court denied. *See Hargreaves v. Nuverra Environmental Solutions Inc.*, No. 21-17 (U.S.). In addition, the Court on October 4, 2021 denied a petition seeking review of the Second Circuit’s equitable mootness decision in *Windstream*. Given the frequency with which petitions seeking review of the doctrine have been filed in recent years, it is likely the Court will eventually take up the issue.

I. *Fulton* and the Scope of the Automatic Stay

Section 362 of the Bankruptcy Code generally prevents a creditor from seizing the debtor’s or estate property after the filing of the debtor’s bankruptcy case. But what if the creditor has already seized the property before the filing? Does the automatic stay prevent the creditor from continuing to hold onto the seized property? Like many other courts of appeals, the Seventh Circuit held that it does. *See, e.g., Weber v. SEFCU (In re Weber)*, 719 F.3d 72 (2d Cir. 2013); *Thompson v. Gen’l Motors Acceptance Corp., LLC*, 566 F.3d 699 (7th Cir. 2009); *Knaus v. Concordia Lumber Co. (In re Knaus)*, 889 F.2d 773 (8th Cir. 1989); *State of California Emp. Dev. Dep’t v. Taxel (In re Del Mission Limited)*, 98 F.3d 1147 (9th Cir. 1996); *In re Rozier*, 376 F.3d 1323 (11th Cir. 2004). Other circuits, however, have gone the other way. *See, e.g., In re Cowen*, 849 F.3d 943, 950 (10th Cir. 2017).

A leading case adopting and illustrating the majority approach was the Second Circuit’s decision in *Weber*. In *Weber*, the debtor financed his truck with a loan from a creditor. 719 F.3d at 74. Under the terms of the loan agreement, the debtor granted a lien on the truck to the creditor to secure repayment of the loan, which lien permitted the creditor to “repossess Weber’s vehicle upon default.” *Id.* After the debtor defaulted, the creditor repossessed the vehicle. Four days later, the debtor filed a chapter 13 bankruptcy petition. *Id.* Notably, repossession of the vehicle

did not divest the debtor of his ownership interest in the truck; it simply permitted the creditor to possess the vehicle pending foreclosure. Thus, when the debtor filed for bankruptcy, the truck became property of the debtor's bankruptcy estate notwithstanding the creditor's possession. Following the Supreme Court's analysis in *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983), the Second Circuit held that, upon the bankruptcy filing, the creditor had a duty to turn over the vehicle to the estate. *See id.* at 79. It further held that the creditor's passive failure to do so constituted a violation of the automatic stay as an act to "'exercise control' over the property of the estate." *Id.* at 79 (quoting 11 U.S.C. § 362).

The Second Circuit focused its analysis on the fact that, by retaining possession of the truck, the creditor was impermissibly exercising control over estate property. *Id.* at 79-80. But the court also found support for its holding in the 1984 amendments to the Bankruptcy Code, which "broadened the already sweeping provisions of the automatic stay even further to prohibit expressly not only 'acts to obtain possession' of property of the estate, but also 'any act . . . to exercise control over the property of the estate.'" *Id.* at 80 (citing Pub. L. No. 98-353, 98 Stat. 333, 371). The court viewed this expansion as a further effort to ensure that the debtor's property is handed over for orderly bankruptcy administration. *Id.* Citing precedent from the Seventh Circuit, the court stated that, "[a]lthough Congress did not provide an explanation of that amendment, the mere fact that Congress expanded the provision to prohibit conduct above and beyond obtaining possession of an asset suggests that it intended to include conduct by creditors who seized an asset pre-petition." *Id.* (quoting *Thompson*, 566 F.3d at 702). Any other outcome, the Second Circuit determined, would "place on the debtor or trustee the burden of undertaking a series of adversary proceedings to pull together the bankruptcy estate"—an outcome inconsistent

with the Supreme Court’s decision in *Whiting Pools* and the turnover provisions of section 542. *Id.*

The Second Circuit’s reference to *Whiting Pools* was relevant because, in *Whiting Pools*, the Court explained that, for bankruptcy purposes, it is immaterial whether a creditor obtains property of the estate before or after bankruptcy is filed. *See Whiting Pools, Inc.*, 462 U.S. at 203-05, 209 (1983) (“We conclude that the reorganization estate includes property of the debtor that has been seized by a creditor prior to the filing of a petition for reorganization.”). That is so, the Court reasoned, because “[b]oth the congressional goal of encouraging reorganizations and Congress’ choice of methods to protect secured creditors suggest that Congress intended a broad range of property to be included in the estate.” *Id.* at 204. The Court then emphasized: “The Bankruptcy Code provides secured creditors various rights . . . and these rights *replace* the protection afforded by possession.” *Id.* at 207 (emphasis added). Critically, the kind of conduct this Court identified as *within* the reach of, and modified by, the Code—mere possession of property of the estate—is precisely the kind of “passive” conduct the court below concluded falls *outside* the scope of the automatic stay.

A leading case adopting the minority approach was *In re Cowen*, 849 F.3d 943, 950 (10th Cir. 2017). In *Cowen*, the Tenth Circuit held that, after the debtor filed his bankruptcy petition, a creditor’s passive act of retaining property seized before the bankruptcy filing did not violate the stay. In reaching its conclusion, the court acknowledged that the majority rule, adopted by most of the Courts of Appeals to have addressed the issue, is that a creditor’s passive conduct may indeed violate the stay. *Id.* at 948-49. Rejecting the majority approach, the court stated that “we adopt the minority rule: only affirmative acts to gain possession of, or to exercise control over, property of the estate violate [the stay].” *Id.* at 950.

Prior to Fulton’s filing of her Chapter 13 bankruptcy case, the City of Chicago impounded her vehicle after discovering that she had been driving on a suspended license. After Fulton filed her bankruptcy case, she demanded the return of her car. Asserting that Fulton owed the City \$11,831.20 in connection with 54 separate and outstanding violations, the City refused. The bankruptcy court, however, determined that the City’s refusal to return the car violated the automatic stay, citing *Thompson v. General Motors Corp.*, 566 F.3d 699 (7th Cir. 2009), and ordered the return of her vehicle. In three other cases involving similarly situated debtors, the City likewise was directed to return impounded vehicles. The City appealed these decisions directly to the Seventh Circuit, which affirmed in all four instances.

Adhering to prior circuit precedent, the court of appeals ruled that the City’s retention of the debtor’s property following the debtor’s bankruptcy case constituted an “act to . . . exercise control” over the property within the meaning of section 362(a)(3). According to the Seventh Circuit, the debtor need not bring an action demanding turnover of the vehicle to prevail; section 362 itself prohibits the continued retention of the property. Recognizing that its decision was contrary to a decision of the Tenth Circuit on the same issue, the Seventh Circuit nonetheless observed that its holding was in line with decisions of the Second, Eighth, and Ninth Circuits (the Eleventh Circuit had likewise adopted the majority view). After the Seventh Circuit issued its decision in the case, the Third Circuit joined the Tenth Circuit in concluding that the automatic stay does not prevent a creditor from continuing to hold onto property seized prior to the debtor’s bankruptcy filing (the D.C. Circuit also follows this approach). The Supreme Court granted certiorari on December 18, 2019.

In its briefs filed in the Supreme Court, the City and its amici contended that the Seventh Circuit misconstrued section 362(a)(3), observing that the statute does not simply prevent the

exercise of control over the debtor's property, but more pointedly "any act" to exercise control over the property. The City contended that the "passive" activity of holding onto property is not an "act" within the meaning of the statute. In addition, the City argued, section 362(a)(3) must be read in context with other provisions of the Code, particularly section 542 governing turnover and section 363 requiring the provision of adequate protection to protect the creditor's interest. According to the City, the Seventh Circuit's approach would render section 542 largely meaningless—a debtor need not seek turnover, but merely have the creditor held in contempt for violating the stay. It would also erode the adequate protection requirement, the City contended, by allowing the debtor to obtain the property without necessarily ensuring the protection of the creditor's interest, forcing the creditor to seek relief from stay.

In contrast, Fulton and her amici contended that the activity of holding onto seized property is as much an "act" as seizing the property itself. Likewise, they contended, the City's argument misconstrues the relationship between sections 362 and 542 by suggesting that turnover is an exclusive remedy if property is not in the debtor's possession. Turnover is certainly available to require parties to transfer property to the estate, but nothing in section 542 indicates that it is exclusive. And once property is returned to the estate, a creditor may seek relief from stay, including on grounds of lack of adequate protection. The creditor, however, is not entitled to short-circuit that process by retaining the property. Oral argument was conducted on October 13, 2020, and a decision was issued on January 14, 2021.

Reversing the Seventh Circuit, the Supreme Court concluded that the "mere" activity of holding onto seized property did not constitute "an act" within the meaning of section 362(a)(3), and thus did not violate the automatic stay. The Court based its reasoning on several considerations.

First, the Court observed that the term “act” typically connotes some kind of assertive conduct. That is certainly true. But in ordinary English, holding onto something is also plainly an “act.” Perhaps more important, creditors that retain seized vehicles after the debtor files for bankruptcy rarely just hold onto the vehicle. In the ordinary course, they also characteristically refuse to give the vehicle back, prevent the debtor from gaining access to it, employ someone to watch over it, and either implicitly or explicitly continue to hold onto the vehicle as a means to leverage the payment of a debt. In conducting its analysis, the Court refused to consider any of these additional activities. In a footnote, the Court observed that, in one of the cases, the Bankruptcy Court had determined that by retaining the debtor’s car *and* demanding payment, “the City also had violated §§362(a)(4) and (a)(6).” The Court stated, however, that the Court of Appeals did not address these considerations and, thus, “[n]either do we.” The Court concluded: “We hold only that mere retention of estate property after the filing of a bankruptcy petition does not violate §362(a)(3) of the Bankruptcy Code.”

Relatedly, the Court also avoided considering the meaning of the phrase “any act” by reference to how the phrase is used in other parts of section 362. The phrase “any act” appears repeatedly throughout the various subsections of section 362, including section 362(a)(4), which enjoins “any act to create, perfect, or enforce any lien against property of the estate.” Among other things, section 362(a)(4) codifies the ancient principle that liens cannot attach to property *in custodia legis*—in the custody of the court. This includes property of the bankruptcy estate, which is constituted in the custody of the federal bankruptcy court. This principle applies regardless of whether the creditor attempts to create the lien “actively” or whether the lien is created “passively” simply by operation of non-bankruptcy law—the lien simply cannot attach.

In figuring out whether the City’s activity of continuing to hold onto the car constituted “an act” to exercise control over property of the estate, one might have thought that the Court would have looked to how the phrase “any act” is used across section 362 to fathom Congress’s intent. Specifically, one might have thought that the Court would have taken a close look at how the phrase is used in the very next subsection—section 362(a)(4). Instead, the Court purposefully avoided parsing the meaning of the same phrase in other parts of the same section.

Second, the Court invoked the canon of construction that disfavors surplusage. The Court’s concern here was about the overlapping scope of sections 362 and 542, and in particular its concern that if section 362 were interpreted to require the City to return the seized property then that would leave little work for section 542 to perform. But as the Court acknowledged, there would still be at least *some* work for section 542, such as by specifying to whom the property was to be returned. So the canon would not seem technically to apply. What the Court did not address clearly was the same concern in reverse: If the City’s conduct does not violate section 362(a)(3), what work does the phrase “exercise control over property of the estate” actually perform? The Court’s cryptic remark was that this language was added simply to deal with “intangible” property.

The Court’s focus on the overlapping nature of sections 362 and 542 is also somewhat odd for a different reason. Overlapping remedies are an everyday occurrence in law, especially commercial law. Think of the various ways creditors may seek to collect on unpaid debts. Under UCC Article 9, secured creditors may pick and choose between a variety of redundant and overlapping remedies, and no one would think twice about curtailing them because the exercise of one renders redundant the exercise of another. *See* UCC § 9-625. Rather, they are simply understood to be cumulative options at the creditors’ disposal.

Third, the Court was concerned that, if section 362 were interpreted to require the return of the vehicles, a conflict would arise between sections 362 and 542 owing to the exception in section 542 excusing turnover if the property is of inconsequential value. But it is hard to see this as a real problem. After all, section 362 is not fully self-executing. Typically, if the debtor or trustee wishes the return of seized property, the debtor or trustee will send a letter to the creditor. If the creditor refuses, then the parties may go to court and the court may enforce the statutory provisions by directing the creditor to cease violating the automatic stay. Obviously, if the property is of inconsequential value, that letter will not be sent and the controversy will never be joined.

Fourth, the Court was reluctant to discuss the practical consequences of its decision. In a concurring opinion, however, Justice Sotomayor did just that. Although she agreed that the City's retention of the debtors' cars did not violate "the letter of the Code," she concluded that it nonetheless "hardly comports with its spirit." She then went on to elaborate how cumbersome, time consuming, and expensive it can be for debtors or trustees to pursue turnover actions under section 542. As she observed, turnover actions can easily take over one hundred days to prosecute and "[o]ne hundred days is a long time to wait for a creditor to return your car, especially when you need that car to get to work so you can earn an income and make your bankruptcy plan payments." This, she noted, is inconsistent with the Code's fundamental policy of providing the debtor with a "fresh start," which all acknowledge section 362 aims to promote. Given Justice Sotomayor's elaboration of the Code's purpose in this context, it seems improbable that Congress intended the consequences that the Court's decision yields, namely forcing debtors to pursue time-consuming and expensive turnover proceedings when the outcome will generally be the same—the creditor must give the car back.

Finally, the Court based its analysis in part on the observation that section 362 is essentially an injunction, and injunctions are often designed to maintain the *status quo*, not alter it. In ordinary terms, it is true that injunctions are often used to maintain the *status quo*. But that is not their only use—as the Court was undoubtedly aware. Injunctions may also be fully remedial, and section 362 is plainly a remedial provision.

J. Rodriguez and the Proper Allocation of Tax Refunds

The IRS allows affiliated groups of corporations to file consolidated tax returns. Under applicable IRS regulations, when a refund is owing, the IRS generally pays the refund to the group’s designated agent and the IRS’s payment to the agent discharges its payment obligation. But how then is the refund to be allocated among members of the group? Affiliated corporate groups frequently enter into tax allocation agreements specifying which members of the group are responsible for paying what part of the group’s tax liability, and likewise how to allocate any refund. But what if there is no such agreement in place or the members of the group dispute its provisions? Absent IRS regulation, should the courts resort to state law to resolve these disputes or follow some principle of federal common law?

Addressing this question, some courts followed what came to be known as the “*Bob Richards*” rule, so-named after the decision of the Ninth Circuit that adopted it: *In re Bob Richards Chrysler-Plymouth Corp.*, 473 F.3d 262 (1973). Under this federal common-law approach, absent a tax allocation agreement, the refund properly belongs to the group member responsible for the losses that led to it. Further expanding the rule, some courts applied it even when the parties had a tax allocation agreement in place.

Rodriguez involved two affiliated entities: United Western Bank (“United Western”) and its parent, United Western Bancorp, Inc. (“UWP”). Notably, the parties had a tax allocation agreement. After suffering substantial losses, United Western was placed into receivership with the FDIC as receiver. Shortly thereafter, UWP was forced into bankruptcy, with Simon Rodriguez appointed as trustee. After the IRS issued a refund, Rodriguez and the FDIC both claimed the money. Unable to resolve their differences, they litigated the matter in the bankruptcy court, district court, and Tenth Circuit. Applying the more expanded version of the *Bob Richards* rule, the Tenth Circuit ruled in favor of the FDIC.

Not all courts, however, followed the *Bob Richards* rule. In order to address this methodological disagreement, the Supreme Court granted certiorari on June 28, 2019. Concluding that there was no need for a federal common-law rule in this instance, the Court vacated the decision of the Tenth Circuit. Remarking that the role of judicial lawmaking in the federal courts is modest at best, the Supreme Court observed that the creation of federal common-law rules must be *necessary* to protect uniquely federal interests. With respect to the collection of taxes, the Court observed that the federal government may well have a vital interest in how it receives the revenue and from whom. But with respect to the allocation of a tax refund among affiliated corporations, no unique federal interest is present and the matter should be resolved through the application of relevant principles of state law.

K. Ritzen and the Finality of Orders Denying Relief from Stay

Under 28 U.S.C. § 158(a), an appeal as of right lies from “final judgments, order, and decrees” entered by bankruptcy judges “in cases and proceedings.” A bankruptcy judge’s order is considered “final” when it resolves a “discrete dispute” within the larger bankruptcy case. As the

Supreme Court ruled in *Bullard v. Blue Hills Bank*, 575 U.S. 496 (2015), whether an order resolves a discrete dispute turns on the context in which the dispute is decided. For example, although an order confirming a plan finally resolves a discrete dispute, an order denying confirmation of a plan does not—at least not where the case continues because, absent dismissal, another plan could be filed and thus the plan confirmation process has not yet concluded. What about an order denying relief from stay? Does that involve the resolution of a sufficiently discrete dispute? In *Ritzen Group, Inc. v. Jackson Masonry, LLC*, the Supreme Court answered in the affirmative.

Prior to Ritzen’s bankruptcy filing, it was embroiled in a breach-of-contract dispute with Jackson over the sale of some real estate that Jackson owned. After a year of litigation, and just days before trial was to begin, Jackson filed its Chapter 11 case. Ritzen filed a motion for relief from stay to allow it to continue the state-court litigation. After a hearing, the bankruptcy court denied the motion. Thereafter, Ritzen filed a proof of claim, Jackson objected, and the bankruptcy court ruled in Jackson’s favor on Ritzen’s breach-of-contract theory and disallowed Ritzen’s claim. Thereafter, Ritzen appealed both the bankruptcy court’s adverse ruling on its claim as well as the bankruptcy court’s denial of its motion for relief from stay.

On appeal, the district court held that Ritzen’s appeal from the bankruptcy court’s ruling denying relief from stay was untimely—Ritzen should have filed its notice of appeal within 14 days after the bankruptcy court entered its stay-relief order. With respect to the bankruptcy court’s resolution of the breach-of-contract claim, the district court ruled against Ritzen on the merits. On further appeal, the Sixth Circuit affirmed. As to timeliness, the court reasoned that the automatic stay proceeding qualified as sufficiently “discrete” for purposes of finality. The court also affirmed the district court on the merits of the breach-of-contract claim. On May 20, 2019, the Supreme Court granted certiorari to review the timeliness question. Affirming the Sixth Circuit, the court

reasoned that a bankruptcy court's order dispositively ruling on a motion for relief from stay is immediately final and appealable.

The Court began by observing how the finality analysis differs in bankruptcy. In ordinary civil litigation, a final order is usually one that ends the litigation as a whole, leaving nothing more for the trial court to do except execute the judgment. In bankruptcy, however, things are different. As the Court observed in *Bullard*, bankruptcy cases typically encompass a multitude of discrete proceedings, many of which would exist as stand-alone lawsuits. The question becomes whether the order in question resolves a dispute that is sufficiently discrete. Figuring that out, the Court observed, requires the proper delineation of the relevant bankruptcy "proceeding" for purposes of finality.

The Court considered two conflicting propositions: (1) Jackson's argument that stay-relief litigation involves is its own discrete proceeding, and (2) Ritzen's claim that the stay-relief litigation in question was simply the first step in determining Ritzen's claim—the relevant proceeding involved the adjudication of Ritzen's breach-of-contract dispute, which was not over until the bankruptcy court ruled on the merits of the claim. As Ritzen observed, the stay-relief question at issue simply involved where its claim would be litigated: in state court or in the bankruptcy court. Ordinarily, orders that deny the transfer of litigation from one court to the next are not final until the end of the litigation. Rejecting Ritzen's argument, the Court concluded that the relief-from-stay process is itself sufficiently discrete that orders denying a motion for relief from stay are properly final.

L. Financial Management and Oversight Board and the Appointments Clause

In 2016, Congress enacted the Puerto Rico Oversight, Management, and Economic Stability Act (“PROMESA”). Among other things, PROMESA created a Financial Oversight and Management Board entrusted with supervising the restructuring of Puerto Rico’s financial affairs, including representing Puerto Rico in bankruptcy proceedings and overseeing aspects of Puerto Rico’s fiscal and budgetary policies. PROMESA provides that the President appoints the seven members of the Board without the advice and consent of the Senate (*i.e.*, Senate confirmation). The question was whether that authorization violated the Appointments Clause of the federal Constitution, which states that the President, with the advice and consent of the Senate, shall appoint “Ambassadors, others public Ministers and Consuls, Judges of the supreme Court, and all other *Officers of the United States*” Art. II, § 2, cl. 2 (emphasis added). The specific question was whether the members of the Board constituted “Officers of the United States” within the meaning of the provision.

After the commencement of Puerto Rico’s bankruptcy proceedings, several creditors moved to dismiss the case on the ground that the Board has been improperly constituted. After the bankruptcy judge denied their motions, the creditors appealed to the First Circuit, which reversed on the basis that the selection of the Board’s members did indeed violate the Appointments Clause. On June 20, 2019, the Supreme Court granted certiorari. On June 20, 2020, it reversed the First Circuit.

In conducting its analysis, the Court found it necessary to reconcile the Appointments Clause with a different set of constitutional provisions: those that empower Congress to create local offices for the District of Columbia and for the Territories of the United States, including Puerto Rico. *See* Art. I, § 8m cl. 17; Art. IV, § 3, cl. 2. As the Court observed, the term “Officials of the United States” has never been understood to cover local officials appointed under these

additional provisions. The question became whether the members of the Board are, on balance, local territorial officials. Reasoning that the Board's duties were indeed local in nature, the Court concluded that the Appointments Clause did not apply in this instance.

In reaching its conclusion, the Court first observed that Congress enacted PROMESA under Article IV of the Constitution, which governs its authority to legislate for the Territories. Although federal personnel acting in Puerto Rico could fall within the scope of the Appointments Clause, territorial officials that have primarily local powers and duties are not "Officials of the United States." As the Court observed, Puerto Rico pays the Board's expenses. The Board's ability to issue subpoenas is subject to limits on personal jurisdiction enforceable under Puerto Rico law. The Board works with the elected government of Puerto Rico and controls the issuance of new debt for Puerto Rico. The Board was authorized to initiate bankruptcy proceedings for Puerto Rico and its instrumentalities in the same manner as any other local government. All told, these indicate the local nature of the duties of the Board. Accordingly, the appointments were proper.

M. Tempnology and the Effect of Rejection

Section 365 of the Bankruptcy Code permits a trustee (or debtor-in-possession) in a bankruptcy case to reject an executory contract. The question raised in *Tempnology* is the effect of rejection. Does it simply mean that the trustee (or debtor) is excused from performing the contract and liable in damages for breach? Or does it also mean that the contract is effectively rescinded, taking away any rights it might have conferred on the non-rejecting party? The First Circuit concluded that the effect in the case was essentially to terminate the non-breaching party's rights.

Before filing for bankruptcy, Tempnology, LLC developed and patented certain cooling fabrics for use in athletic apparel and accessories. Tempnology granted a non-exclusive license to Mission Product Holdings to use Tempnology's marks and an exclusive right to distribute Tempnology's patented products within a certain territory. After Tempnology filed for bankruptcy, it rejected its agreement with Mission, planning to relicense the technology and distribute its products on more favorable terms. Mission argued that Tempnology's rejection of the contract did not terminate Mission's right to use the marks and distribute the products; it simply constituted breach of the agreement. Tempnology contended that rejection did indeed terminate Mission's rights, leaving Tempnology free to do business with someone else. As noted, the First Circuit agreed with Tempnology. On Mission's petition for certiorari, the Supreme Court granted review limited to the first question raised in the petition: whether rejection of a license agreement terminates the rights of the licensee. The Court declined review of Mission's second question: whether an exclusive right to sell is a right to intellectual property protected under section 365(n) of the Code.

This is not the first time that a court of appeals has ruled that the effect of rejection is to rescind an agreement, depriving the non-rejecting party of its rights. In 1985, the Fourth Circuit ruled in the *Lubrizol* case that the debtor's rejection of a technology license stripped the licensee of its right to use the technology. See *Lubrizon Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985). In response to *Lubrizol*, Congress swiftly enacted section 365(n), which provides that, when a debtor rejects a license of "intellectual property," the licensee may nonetheless opt to retain its right to use the relevant technology. The trouble, however, lies in the Code's definition of "intellectual property." The phrase includes patents and copyrights, but does not mention trademarks. Some have interpreted this to mean that trademarks are not

protected and that rejection does indeed rescind the licensee's rights. Others have contended that section 365(n) represents a broad repudiation of *Lubrizol* and that licensees of trademarks are protected to the same extent as licensees of patents and copyrights, with the failure to include trademarks within the definition of intellectual property as perhaps just an oversight. Still others have contended that *Lubrizol* was simply wrong and that the only consequence of rejection is that the agreement is breached (as section 365(g) expressly provides); the licensee's right to continue using the mark is not ended regardless of what section 365(n) provides.

In its merits brief, Mission raised essentially three arguments why its rights were not terminated. First, it contended that, as section 365(g) expressly provides, rejection constitutes breach, not rescission, with only the ordinary consequences of breach. Notably, it argued that rejection is not an avoidance concept and thus cannot give the debtor greater rights than it would have outside of bankruptcy. Thus, its rights as a licensee are not terminated. Mission faulted the First Circuit for failing to apply these basic principles.

Second, Mission argued that rejection of the agreement did not otherwise revoke any of its licensing rights under the agreement, including its exclusive right to distribute the patented product and its non-exclusive right to use the Tempnology marks, because these are essentially forms of property rights that rejection does not reach. In making this argument, Mission construed both its right to use the Tempnology marks and its right to sell the Tempnology product as types of technology licenses (a characterization rejected by the First Circuit, which concluded that Mission's right to sell was simply the right of an ordinary distributor). Specifically, Mission argued that its exclusive right to sell encompassed the right to sell products "practicing Tempnology's patents and bearing its trademarks."

Third, Mission contended that section 364(n) does not support the inference that, because trademarks are not expressly included in the definition of “intellectual property,” therefore they are not protected. Mission argued that there is no reason to treat trademarks differently from patents and copyrights. Finally, Mission argued that the reorganization policies of Chapter 11 do not justify treating rejection as an avoidance power.

In its merits brief, Tempnology presented essentially three responses. First, it contended that the treatment of Mission’s exclusive right to sell was outside the singular question that the Court accepted for review. According to Tempnology, its agreement with Mission distinguished Mission’s non-exclusive license to use Tempnology’s intellectual property and Mission’s exclusive product distribution rights. Tempnology noted that the Court had granted review only with respect to Mission’s rights as a licensee and the effect of rejection thereon, and not with respect to Mission’s additional question concerning its distribution rights. Tempnology contended further that, if Mission’s distribution rights were not at issue, the case is moot because Mission’s non-exclusive license to use Tempnology’s intellectual property expired in 2016.

Assuming a live controversy, Tempnology next argued that a rejected contract is unenforceable against the debtor’s estate, except to the extent the Bankruptcy Code otherwise provides. As a result, once a contract is rejected, the non-rejecting party’s only recourse is to assert a claim for damages, not the debtor’s performance of its obligations. Because Congress has not granted licensees of trademarks any special remedies, Mission’s only remedy is to assert a claim for damages for breach. According to Tempnology, this is supported by the reality that the non-rejecting party to a rejected agreement has no right to have its claim treated as one entitled to administrative priority. In support of its position, Tempnology also argued that Mission’s exclusive right to distribute Tempnology products is not a property right; it is simply a contract

right to sell products that Tempnology manufactures, that incorporate Tempnology's patented processes or materials, or that bear the Tempnology marks. Nothing in section 365 protects such distribution rights.

Third, Tempnology argued that there are good reasons to treat trademarks differently from other kinds of intellectual property protected under section 365(n). Unlike patents and copyrights, trademarks and the goodwill accompanying them must always be owned by a single owner, who has the right to exercise control over the nature and quality of the relevant goods or services covered by the mark. A licensee simply does not acquire the rights of an owner, and thus does not acquire a property right in the same sense as the licensee of a copyright or patent. That is especially so where, as here, the licensee holds a non-exclusive license. In addition, Tempnology argued that treating Mission's rights in the manner endorsed by the First Circuit was essential to facilitate the reorganization of businesses like Tempnology.

Numerous amici filed briefs supporting Mission's position. Two amicus briefs were filed in support of neither party. No amicus brief was filed in support of Tempnology. Oral argument was conducted on February 20, 2019. On May 20, 2019, the Supreme Court issued its opinion reversing the First Circuit.

The Court began by addressing the effect of rejection, specifically whether it constitutes a breach of the agreement giving rise to a claim for damages, or whether it has the effect of rescission. Concluding that rejection merely has the effect of breach, the Court reasoned that Tempnology's rejection in this case did not terminate any of Mission's rights. In reaching its conclusion, the Court observed that the power to reject a contract is not the power to avoid a non-debtor party's rights, and that a debtor may not effectively use its authority to reject a contract to expand its own rights. Nor did the Court believe that, when Congress specifically intervened after

Lubrizol to protect patent and copyright interests, its failure to mention trademarks meant Congress intended debtors to be able to circumvent those rights. That argument, the Court reasoned, paid too little attention to the main provisions governing rejection (*e.g.*, that it constitutes a breach) and too much to subsidiary provisions (*e.g.*, section 365(n)) specifying further details in particular cases in response to specific problems that required legislative correction (*e.g.*, *Lubrizol*). It might be true, the Court observed, that permitting a debtor to use rejection to terminate the rights of a non-debtor party might assist with the debtor’s reorganization. It is likewise true, the Court noted, that one of the main goals of bankruptcy is to facilitate reorganization. Nonetheless, the Court stated, the Code “does not permit anything and everything that might advance that goal.”

N. Taggart and the Effect of Good Faith in Addressing Violations of the Discharge Injunction

Section 524(a) provides that the grant of a discharge in a bankruptcy case “operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any [discharged] debt as a personal liability of the debtor, whether or not discharge of such debt is waived” 11 U.S.C. § 524(a). Respondents (a group of individuals) sued petitioner (Taggart) in state court for wrongfully transferring their interests in a limited liability company without honoring their right of first refusal. On the eve of trial, Taggart filed for Chapter 7 bankruptcy relief and ultimately obtained a discharge. Thereafter, Taggart sought to be dismissed from the state-court litigation, owing to the discharge granted in his bankruptcy case. The trial court, however, refused, determining that Taggart was a necessary party, even though the parties had agreed not to pursue a money judgment against him. After

respondents prevailed at trial, they sought attorneys' fees from Taggart, arguing that his post-bankruptcy participation in the case fell outside the reach of the discharge injunction.

In response, Taggart moved to reopen his bankruptcy case and sought to hold respondents in contempt for violating the discharge injunction. The issue was simultaneously litigated in both state and federal court. Ultimately, various courts determined that respondents had indeed violated the discharge injunction. The bankruptcy court in particular found the violation to be willful and determined (as is relevant here) that there is no "good faith belief" defense. The court awarded \$5,000.00 in noneconomic damages and approximately \$105,000.00 in fees and costs that Taggart had incurred. The court also added \$2,000.00 in punitive damages for respondents' failure to timely vacate the state-court judgment against Taggart.

On appeal, the bankruptcy appellate panel reversed, concluding that the bankruptcy court had erred in determining that respondents' subjective or good faith beliefs were irrelevant. On further appeal, the Ninth Circuit affirmed the bankruptcy appellate panel, concluding that respondents could not be held in contempt because they believed in good faith that the discharge injunction was inapplicable. According to the Ninth Circuit, a creditor's good faith belief excuses a violation of the discharge injunction, even if the creditor's belief is unreasonable. Because it was uncontested that respondents possessed a good faith belief that the discharge injunction did not apply to their claims, their belief, even if unreasonable, protected them from contempt. In seeking certiorari review, Taggart contended that the Ninth Circuit's standard conflicts irreconcilably with that of the Eleventh Circuit as set forth in various cases, including *In re Hardy*, 97 F.3d 1384 (11th Cir. 1996), in which the court concluded that relief is available for violations of the discharge injunction irrespective of the creditor's good faith. Taggart likewise contended

that the Ninth Circuit’s standard conflicts with decisions from the First and Fourth Circuits. The Court granted certiorari on January 4, 2019.

On June 3, 2019, the Court issued its decision reversing the Ninth Circuit. Rejecting both a “strict liability approach,” and likewise the Ninth Circuit’s standard that effectively excused a violation if the creditor has a subjective “good faith belief” that the discharge order does not apply to the creditor’s conduct, the Court instead adopted a different test: a creditor may be held in civil contempt for violating the discharge injunction if “there is no fair ground for doubt as to whether the order barred the creditor’s conduct.” Rephrasing its standard, the Court explained: “[i]n other words, civil contempt may be appropriate if there is no objectively reasonable basis for concluding that the creditor’s conduct might be unlawful.”

In reaching its conclusion, the Court began by considering sections 524 of the Code, which “operates as an injunction” to prevent debt-collection activity with respect to discharged obligations, and section 105, which authorizes a court to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. §§ 105(a), 524(a). Applying the canon that, when a statutory term is transplanted from another legal source, it “brings the old soil with it,” the Court concluded that these provisions, drawn generally from the law of injunctions, should be interpreted in a manner consistent with how injunctions are generally enforced.

As the Court noted, injunctions are generally enforceable through civil contempt. And in general, civil contempt is warranted only when there is “no fair ground for doubt” as to the wrongfulness of the defendant’s conduct. Observing that this standard is an objective one, the Court rejected the Ninth Circuit’s subjective approach. As the Court reasoned, the absence of willfulness does not excuse civil contempt. The Court concluded: “[u]nder the fair ground of

doubt standard, civil contempt therefore may be appropriate when the creditor violates a discharge order based on an objectively unreasonable understanding of the discharge order or the statutes that govern its scope.”

O. Village at Lakeridge and Appellate Standards of Review

In a Chapter 11 cram-down case, if a class of claims is impaired, at least one impaired class must vote in favor of the plan in order for the plan to be confirmed, excluding insider votes. 11 U.S.C. § 1129(a)(10). The Code defines insiders to include various persons (known as statutory insiders), but the list is not exhaustive. Others who are sufficiently close to the debtor may also be deemed to be insiders (known as non-statutory insiders). The issue the Supreme Court took for consideration is *not* the resolution of various disputes over the correct test for determining whether a creditor is a non-statutory insider, but rather the standard of review that an appellate court should use in reviewing the decision of a bankruptcy court applying the relevant criteria (whatever they are) to the facts of the case to determine whether the creditor is a non-statutory insider. Ordinarily, courts of appeals review questions of law *de novo*, and questions of fact under the clearly erroneous standard. When it comes to applying the law to the facts, however, some courts have characteristically reviewed the bankruptcy judge’s *application* of the law to the facts (assuming the bankruptcy judge has stated the legal test correctly) under the clearly erroneous standard, while others have reviewed it *de novo*.

The facts of the case are colorful. MBP Equity Partners was the equity owner of the Village at Lakeridge, the debtor. U.S. Bank held an approximately \$10 million claim against Lakeridge secured by a mortgage lien. MBP held an unsecured claims against Lakeridge in the amount of approximately \$2.76 million. Lakeridge proposed to confirm a cram down plan that impaired the

rights of U.S. Bank and needed at least one impaired class to vote in favor of the plan, but the claim it held was obviously the claim of an insider. So MBP, acting through one of its board members (Ms. Bartlett), sold its claim to an investor (Dr. Rabkin) for \$5,000. Ms. Bartlett and Dr. Rabkin were romantically involved.

The bankruptcy court determined that Dr. Rabkin was not a non-statutory insider. The bankruptcy appellate panel reversed, and the Ninth Circuit reversed the bankruptcy appellate panel. The Ninth Circuit reasoned that it reviewed the bankruptcy court's determinations of fact under the clearly erroneous standard, and its conclusions of law *de novo*. Classifying the bankruptcy court's application of the law to the facts as falling within the scope of its clearly erroneous review, a majority of the three-judge panel concluded that the decision was not clearly erroneous (the bankruptcy court having more or less stated the correct legal standard).

In the Supreme Court, U.S. Bank argued that the bankruptcy judge's application of the law to the facts should be reviewed *de novo*, just like questions of law generally. U.S. Bank contended that, among other things, doing so offers important law-clarifying benefits. Lakeridge argued that the bankruptcy judge's application of the law to the facts should be reviewed under the clearly erroneous standard, just like pure questions of fact. Lakeridge argued that the application of the legal standard to the facts is essentially like determinations of fact that the bankruptcy judge is in the best position to assess. The United States filed an amicus brief siding with Lakeridge.

At oral argument, the Justices asked a number of far-ranging questions about method, the capacity of appellate judges to conduct appellate review, and the practical implications of one standard over the other. In rendering its decision, the Court decided for the debtor (and the United States), concluding that a clear error standard applied.

In conducting its analysis of the legal issue of what standard of review properly applies, the court first differentiated three distinct kinds of inquiry: those that are purely legal (*i.e.*, what is the relevant legal rule or test), those that are purely factual (*i.e.*, what happened in the case of relevance to that test), and those that are a combination of the two (*i.e.*, how is the law to be applied to the particular facts). On the first question, the Court noted (without deciding its merits) that the Ninth Circuit applies a two-part test for non-statutory insider status: whether the person's relationship with the debtor was similar to those listed as statutory insiders, and whether the relevant transaction had been conducted at less than arm's length. The Court took this standard as the given test in deciding the case. Ordinarily such questions are reviewed *de novo*, but the Court did not grant certiorari on this purely legal question. Accordingly, the Court did not decide its merits (although several justices stated in concurrence that they doubted the Ninth Circuit's test was correct).

On the second question, the Court observed that the bankruptcy court made numerous "basic" or "historic" findings of facts regarding what actually happened in the case. The Court noted that the set of relevant facts in any particular instance will turn on the legal test used. In this case, the relevant factual determinations included those surrounding Rabkin's relationship with Bartlett, such as whether they lived together or paid each other's living expenses, and Rabkin's motives for purchasing the claim against the debtor. The Court observed that such determinations are ordinarily reviewed on appeal under the clearly erroneous standard, which affords great deference to the trial court's findings.

On the third question, which was the real bone of contention, the Court characterized the inquiry as involving so-called "mixed questions" of law and fact. Essentially, the third question involves considering whether the facts satisfy the legal test chosen for the resolution of the matter.

As noted, the bankruptcy court had determined that the facts did not show the kind of transaction necessary to confer insider status. The question the Court was called up to answer was whether this determination should be reviewed *de novo* or for clear error.

The Court observed that, in general, there is no clear-cut answer to this question because mixed questions of law and fact are not all alike. Sometimes they require a court to expound on the law, such as when they require the elaboration of a legal standard. In such instances, the Court reasoned that appellate courts should review the trial court's determination *de novo*. In other instances, however, the determination is much more intensely factual. In such instances, the Court determined that appellate courts should review the trial court's determination under the highly deferential clearly erroneous rule.

In this case, the Court held that the determination of Rabkin's insider status under the relevant legal test was about as fact-bound as it gets. The nature of the inquiry was such that the bankruptcy court was required to take a raft of case-specific facts and make a determination of whether, on balance, they showed that the parties were acting more like strangers or more like insiders. Conversely, the Court reasoned that, in making its determination, the bankruptcy court was required to do relatively little legal work (other than selecting the correct legal standard). Rather, the bankruptcy court's work essentially involved characterizing the totality of the facts.

The Court's decision thus leaves it up to the lower appellate courts to figure out in each case what is more predominant in the application of the law to the fact—the law or the facts. In some instances, this is likely to be relatively straightforward. In others, it is likely to be more complex. For example, if the law is relatively unsettled, and the application of the law to the facts requires significant illustration of the kinds of things the law is intended to encompass, one would imagine the appellate court opting for *de novo* review. In more run-of-the mill cases in which

factual analysis predominates, however, the appellate court is likely to opt for the clear error standard.

P. Merit and Pass-Through Transfers Under Section 546(e)

Section 546(e) of the Bankruptcy Code renders unavoidable a transfer “by or to (or for the benefit of)” a financial institution. 11 U.S.C. § 546(e). The issue addressed in the case is whether a transfer that simply passes through a financial institution is insulated from avoidance, or whether the section protects only those transfers in which a financial interest holds a beneficial interest. The Seventh Circuit, following the Eleventh Circuit, ruled that the section shelters only those transfers in which the financial institution holds a beneficial interest, and not where the financial institution serves merely as a conduit. In contrast, the Second, Third, Sixth, Eighth, and Tenth Circuits have held to the contrary.

The facts of the case, although layered, are straightforward. Valley View, the debtor, wanted to establish a racing track and casino in Pennsylvania, for which it needed both a racing license and a gaming license. Valley View was in competition with Bedford Downs for the last racing license in the state when the two decided to combine forces through a leveraged buyout in which Valley View agreed to buy the stock of Bedford Downs with borrowed funds from Credit Suisse and other lenders. The purchase money was escrowed at Citizens Bank. Merit Management, the owner of approximately thirty percent of Bedford Downs, surrendered its stock to Citizens Bank in exchange for approximately \$16.5 million.

Unable to obtain a gaming license, Valley View filed for bankruptcy in 2009. FTI Consulting, as trustee under the litigation trust tasked with pursuing Valley View’s avoidance actions, brought suit against Merit Management in Illinois under sections 544, 548, and 550 of the

Bankruptcy Code. FTI's theory was that the \$16.5 million transfer to Merit Management was a fraudulent conveyance. Merit Management argued that section 546(e) rendered the transfer unavoidable on the basis of the involvement of Credit Suisse as lender and Citizens Bank as escrow agent. The district court ruled in favor of Merit Management and FTI appealed to the Seventh Circuit.

The Seventh Circuit reversed. It determined that the relevant text of section 546(e) is ambiguous. It analogized the situation to one in which a person sends a postcard through the U.S. Postal Service. On the one hand, the sender can be thought of as sending the card by or through the mail. On the other hand, the postal service can be thought of as doing the sending. Because the language is ambiguous, the court looked to the section's history and purpose, as well as other indicia of meaning.

In particular, the court traced the history of section 546 through the course of three amendments. The first, in 1982, added protection for margin and settlement payments involving commodity brokers, forward contract merchants, stock brokers, and securities clearing agencies. The second, in 1984, added financial institutions to the list. The third, in 2006, added the "(or for the benefit of)" language. After reviewing the history, the court reasoned that the intent was to protect the named parties with respect to transfers in which they have a beneficial interest, not simply in situations in which they serve merely as conduits for others. The court acknowledged that its decision deepened a pre-existing circuit split.

The Supreme Court granted certiorari to address the conflict among the courts of appeals. In the Supreme Court, Merit Management understandably focused heavily on the text of section 546(e), contending that it literally applied to the relevant transfer in question. In contrast, FTI understandably focused on the history and purpose of the section, as well as its place in context

with other provisions of the Code. During oral argument, Justice Ginsburg was particularly interested in the fact that Merit Management is not a financial institution. Justice Kagan inquired whether the focus ought to be on the transfer being avoided, rather than the path the transfer took. The justices otherwise asked a number of pointed questions about section 546(e) and its operation.

In affirming the Seventh Circuit, the Court nonetheless began by rejecting the lower court’s determination that the statutory language is ambiguous. After summarizing the avoidance powers generally, the Court then turned to the limitations on those powers set forth in section 546(e). After quoting the section, the Court reviewed its history, particularly the various amendments adding various provisions, culminating in the current text. With that as background (and after summarizing the facts) the Court identified the relevant question as whether “the transfer between Valley View and Merit implicates the safe harbor exception because the transfer was ‘made by or to (or for the benefit of) a . . . financial institution.’” *Merit*, 138 S. Ct. at 892. In answering this question, the Court reasoned that it first had to identify the nature of the relevant transfer. Rejecting Merit’s argument that it should look at each component part of the transfer individually, the Court concluded that, as FTI argued, there was, in fact, only one overarching transfer—that between Valley View and Merit for \$16.5 million. Because that transfer was not made by, to, or for the benefit of a financial institution, the safe harbor did not apply. The Court determined that this conclusion followed from the language of section 546(e), the context in which it is used, and the broader statutory structure of which section 546(e) is a part.

Beginning with the text, the Court reasoned that the very first clause of section 546(e)—“Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title”—suggests that the relevant inquiry is on the transfer the trustee seeks to avoid—here the \$16.5 million from Valley View to Merit. Likewise the very last clause—“except under section 548(a)(1)(A) of this title”—

suggests the same thing because it creates an exception to the exception for an actually fraudulent transfer, again focusing on the transfer in question that the trustee is seeking to avoid. Further supporting its interpretation, the Court noted that the statutory text provides that a transfer the “trustee may not avoid” is designated in as “a transfer that *is*” either a settlement payment or made in connection with a securities contract. The Court considered relevant that the statutory language did not say “a transfer that involves” or that “is connected with” such things, but rather a transfer that “is” those things.—further supporting its conclusion that what matters is the transfer the trustee is seeking to avoid, not its component parts.

The Court then turned to the relevant statutory structure. Here it adopted the reasoning of the Seventh Circuit—namely, that the system for avoiding transfers, together with the safe harbor from avoidance, are logically two sides of the same coin. Notably, the avoidance provisions designate the characteristics of transfers the trustee may avoid. Likewise, the safe harbor exception logically does the same. There is no reason, the Court concluded, “to examine the relevant component parts when considering a limit to the avoiding power, where that limit is defined by reference to an otherwise avoidable transfer, as is the case with § 546(e)” *Id.*, at 894-95.

In conducting its analysis, the Court also rejected Merit’s argument that the phrase “(or for the benefit of)” added to section 546(e) in 2006 was intended to overrule the Eleventh Circuit’s decision in *In re Munford, Inc.*, 98 F.3d 604, 610 (11th Cir. 1996), which held that the safe harbor was inapplicable to transfers in which a financial institution was only an intermediary. The Court reasoned that nothing in the text or its legislative history corroborated that proposition, and likewise that there was a simpler explanation: a number of avoidance provisions use this same language, so it made sense that Congress would add it to section 546(e) so that the provisions all matched. The Court likewise rejected Merit’s argument that its interpretation was compelled by

reference to the purpose of the safe harbor. Merit argued that section 546(e) was intended as a broad and comprehensive protection. The Court concluded, however, that Merit’s purposive argument was unavailing because it conflicted with the plain language of the statute.

Q. Lamar and the Fraud Discharge Exception

Section 523(a)(2)(A) excepts from discharge “any debt . . . for money, property [or] services . . . to the extent obtained by . . . false pretenses, a false representation, or actual fraud, *other than a statement respecting the debtor’s . . . financial condition.*” 11 U.S.C. § 523(a)(2) (emphasis added). If the creditor claims a debt should not be discharged under this provision owing to a false or fraudulent statement regarding the debtor’s financial condition, section 523(a)(2)(B) additionally requires that the statement must be in writing and that the creditor must show the debtor’s intent to deceive. In other words, there are heightened requirements for the non-dischargeability of a debt based on a statement respecting the debtor’s financial condition. The issue in the case is whether a debtor’s statement regarding a tax refund that the debtor anticipated receiving is a statement respecting the debtor’s financial condition such that the additional requirements apply, or whether it is simply a statement regarding a particular asset that otherwise falls within the scope of section 523(a)(2)(A).

The creditor in the case is a law firm that did work for the debtor. After the firm became concerned that the debtor was not paying his bills, the firm inquired about the debtor’s ability to pay. The debtor represented orally that he was going to get a large tax refund. In fact, the tax refund that the debtor anticipated receiving was less than he represented and, when the debtor received it, he used it to pay other debts, leaving the firm unpaid. After the debtor filed for bankruptcy relief, the firm moved to have its claim determined to be non-dischargeable. The

bankruptcy and district courts ruled for the firm. The Eleventh Circuit, however, ruled in favor of the debtor. On certiorari review, the Supreme Court affirmed the Eleventh Circuit.

In reaching its decision, the Court zeroed in on the meaning of the phrase “statement respecting the debtor’s financial condition.” The Court asked: “Does a statement about a single asset qualify, or must the statement be about the debtor’s overall financial condition?” The Court reasoned that the answer to this question matters because the statement at issue was just about a single asset—the tax refund. The Court concluded that the relevant statutory language, particularly the term “respecting,” makes it plain that a statement about a single asset can be a “statement respecting the debtor’s financial condition.” Accordingly, if the statement is not in writing, the associated debt may be discharged, even if the statement was untrue.

The Court began by observing that, one of the main purposes of the Nation’s bankruptcy laws is “to aid the honest but unfortunate debtor by giving him a fresh start in life, free from debts, except of a certain character.” *Lamar*, 138 S. Ct. at 1758 (citations and marks omitted). In order to decide if the debt in this case is of such a “certain character,” the Court determined that it had to closely examine the relevant text of section 523(a)(2) to see what it includes and excludes. The Court began its analysis by observing that there was no dispute regarding the meaning of the terms “statement” or “financial condition.” What matters is the meaning of the “key word” that appears between these terms in the statutory text: the word “respecting.” Rejecting Lamar’s narrow reading of the term, the Court concluded that there was no basis to believe that the term had a meaning materially different from “about,” “concerning,” “with reference to,” or “as regards.” Because a statement regarding a single asset can be about or concerning or with reference to or as regards a debtor’s financial condition, such a statement can also be one respecting a debtor’s financial condition. Noting that the Court typically reads the word “respecting” broadly, it saw no

reason to depart from that tradition in this setting—particularly where it concluded that adopting a more restricted interpretation would lead to anomalous results.

In further support of its analysis, the Court cited the legislative history. The relevant language has long been a part of the fraud discharge exception, and courts of appeals have long concluded that the language encompasses statements addressing just one or some of a debtor’s assets or liabilities. Applying the canon that, when Congress uses the same language in a statute through multiple recodifications it presumably is aware of and intends to retain the judicial interpretations of it, the Court reasoned that this further bolstered its plain reading analysis. Finally, the Court rejected Lamar’s argument that Applying’s interpretation undermines the purpose of section 523(a)(3), or the general principle that bankruptcy relief is available only to the honest but unfortunate debtor. The Court noted that section 523(a)(2) attempts to balance debtor relief against a history of creditor abuse. As the Court observed, some finance companies had historically encouraged their borrower’s falsity for the purpose of insulating their claims from discharge in bankruptcy. The Court’s advice: creditors should ensure that the debtor’s statements on which they rely in extending credit are in writing.

R. Jevic and Structured Dismissals

The Bankruptcy Code authorizes the dismissal of Chapter 11 bankruptcy cases and generally provides that, unless the court for cause orders otherwise, dismissal has the effect of returning the parties to the status quo immediately prior to the commencement of the case. *See* 11 U.S.C. §§ 349, 1112. Rather than return the parties to the status quo, however, some courts have approved “structured dismissals” that effectively distribute the value of the debtor’s assets in various ways, approve the release of various parties, and/or settle various claims. These structured

dismissals may or may not comply with the Code's priority rules. The question presented in *Jevic* was whether a structured dismissal that did not comply with absolute priority is something a bankruptcy court is authorized to approve and, if so, under what circumstances.

Jevic Transportation was in the trucking business. Prior to filing for bankruptcy, Jevic engaged in a leverage buyout transaction in which Sun Capital Partners acquired the company. Various lenders led by CIT financed the buyout and provided Jevic with an \$85 million revolving line of credit. After Jevic's finances continued to deteriorate, the company decided to file for bankruptcy. It ceased operations, notified its employees of their impending termination, and commenced a Chapter 11 proceeding in Delaware. At the time, Jevic owed its lenders and Sun approximately \$53 million secured by liens on the company's assets. It owed an additional \$20 million to taxing authorities and general unsecured creditors. An official committee of unsecured creditors was appointed.

After the commencement of the bankruptcy case, a group of Jevic's terminated truck drivers filed a class action against Jevic and Sun, alleging violations of federal and state WARN acts, under which Jevic was supposed to provide 60 days' written notice before laying them off. In addition, the creditors' committee brought a fraudulent transfer action against CIT and Sun, alleging that Sun, with CIT's help, took over Jevic with essentially none of its own money in an ill-conceived transaction that placed Jevic in an unreasonably precarious financial position.

Several years later, the bankruptcy court granted in part and denied in part CIT's motion to dismiss the litigation. Thereafter, representatives of the committee, Sun, CIT, Jevic, and the drivers convened to negotiate a settlement. Previously, all of Jevic's assets had been liquidated to pay the lender group led by CIT. By the time of the settlement discussions, all that was left of

Jevic was about \$1.7 million in cash, which was subject to Sun's lien, and the fraudulent transfer action against CIT and Sun.

Eventually the committee, Jevic, CIT, and Sun reached a settlement agreement with four essential features. First, the parties would release each other, and the fraudulent transfer litigation would be dismissed. Second, CIT would pay \$2 million to fund the payment of administrative expenses. Third, Sun would assign its lien on the \$1.7 million in cash to pay tax and administrative creditors first, and then to distribute something to general unsecured creditors. Fourth, the bankruptcy case would be dismissed. In this way, the settlement contemplated a structured dismissal that provided for the distribution of Jevic's remaining assets. It left out, however, the drivers, who had asserted approximately \$8.3 million in wage claims entitled to priority under section 507(a)(4) of the Code. Apparently the drivers had been unable to reach a settlement against Sun on their WARN act claims, and Sun was unwilling to agree to any distribution to the drivers so long as their litigation against Sun remained pending.

The drivers and the U.S. Trustee objected to the proposed settlement and structured dismissal. In particular, they claimed that the dismissal violated the Code's priority scheme by authorizing a distribution to general unsecured creditors while the drivers' priority wage claims received nothing. Rejecting these arguments, the bankruptcy court approved the settlement and the structured dismissal. The court reasoned that other courts has granted similar relief in other cases. The court also observed that dire circumstances existed and that, absent the settlement, there was no meaningful prospect of any distribution to anyone other than the secured creditors because completing a Chapter 11 bankruptcy was impractical, as was conversion to a Chapter 7 case. In essence, there was no cash available to fund any further bankruptcy proceedings because all of the available cash was encumbered by Sun's lien.

Although the bankruptcy court observed that Chapter 11 plans cannot violate absolute priority over the objection of creditors, it concluded that there was no similar restriction for settlements. The court found that the drivers' claims against Jevic were essentially worthless because there was no unencumbered cash that could be distributed to them. On appeal, the district court affirmed, as did the Third Circuit, which held that, in rare instances such as the present case, courts could approve structured dismissals. The Third Circuit believed that, in this case, there was no real alternative and observed that, although structured dismissals might not be used simply to evade the Code's procedural protections and safeguards, there was in this matter no prospect of either a confirmable plan or a viable Chapter 7 case. In addition, the court determined that, although skipping a priority class in favor of distributions to a junior class raises justifiable concerns, it could be done where there are specific and credible grounds that justify the deviation. In this matter, although the drivers were left out in the cold, the bankruptcy court concluded correctly, the court believed, that the settlement best served the interests of the estate and its creditors because further litigation would merely deplete the assets of the estate with little prospect of assisting anyone.

In the Supreme Court, the drivers argued that the absolute priority standard applied equally to settlements as well as plans of reorganization. The drivers reasoned that this was essential to effectuate Congress's policy choice in elevating certain creditors over others. Unlike financial creditors, employees are poor loss spreaders, hence their priority treatment, which should be respected.

In addition, the drivers noted, if they could be skipped over in this case, doing so would serve to open the door to further violations of absolute priority in the future. Settling parties, they noted, should not be permitted to get away with deviations from absolute priority simply because

they claim they would not settle unless another creditor group is cut out. The drivers warned that, if approved, exceptional deviations from absolute priority would likely become commonplace. This, they contended, would have dire effects for the negotiation of Chapter 11 plans because it would effectively provide a green light for collusion and undermine the kind of predictability that adherence to absolute priority fosters. This, the drivers warned, would effectively marginalize creditors like the drivers in this case, who generally lack the clout of financial creditors.

In contrast, the several respondents argued that the concept of absolute priority does not superintend the approval of settlements. By the Code's terms, they argued, absolute priority has become codified in the confirmation provisions, but not the rules that govern settlements. Moreover, although a plan must comply with the Code's priority regime set forth in section 507, nothing in the Code mandates the same for settlement agreements.

Respondents also focused on the impossibility of alternative relief. Absent a settlement, there was likely to be nothing to distribute to anyone, other than the secured creditors. Simply put, the settlement was the best vehicle to maximize distributions to creditors. Further, as the bankruptcy court determined, the drivers' claims were essentially worthless because there was essentially no cash available to distribute to them. The distribution to the unsecured creditors simply took funds out of the secured creditors' pockets, so there was no harm to the drivers in any event.

Countering the drivers' policy concerns, respondents argued that siding with the drivers would grant recalcitrant priority creditors too much leverage by encouraging them to demand payment even when doing so would destroy any hope of maximizing value through the settlement process. Although the drivers might have that leverage in the plan process, respondents argued that they do not have it in the settlement context.

Ruling for the drivers, the Supreme Court held that a distribution scheme ordered in the context of a structured dismissal cannot, without the consent of the affected parties, deviate from the ordinary priority rules applicable to distributions under the Bankruptcy Code. The Court noted that the Bankruptcy Code's priority scheme "constitutes a basic underpinning of business bankruptcy law." The Court reasoned that, because of the centrality of this scheme, if Congress had intended to depart from the existing priority rules in the context of the approval of dismissals under section 349, one would expect some affirmative indication of this intent, observing "Congress ... does not ... hide elephants in mouseholes."

Based on its review of the Code, the Court found nothing demonstrating such intent. Nor did the Court believe that precedent supported respondents' position. The Court distinguished situations in which lower courts have approved *interim* distributions that violate absolute priority where these distributions have served Code-related objectives, including various first-day orders. The Court observed that those kinds of distributions are commonly justified as enabling a successful reorganization. In contrast, a structured dismissal involves a final disposition that does not serve the same goal. In particular, it does not preserve the debtor as a going concern, offer the prospect of making disfavored creditors better off, promote the possibility of a confirmable plan, restore the status quo, or protect the reliance interests of creditors who have obtained interests during the course of the bankruptcy case.

Finally, the Supreme Court flatly rejected a "rare case" exception based on "sufficient reasons" in particular cases. The Court was blunt in holding that "it is difficult to give precise content to the concept [of] 'sufficient reasons,'" and expressed the concern that a rare case exception could turn into a more general rule. Specifically, the Court stated that "Congress did

not authorize a ‘rare case’ exception [and w]e cannot ‘alter the balance struck by the statute’...
not even in “rare cases.”²

² Justice Thomas authored a dissent, joined by Justice Alito. The dissent noted that the Court had granted certiorari on a particular question, but the Petitioners had argued (and the Court decided) another question. Given the switch, the dissent would have dismissed the writ of certiorari as improvidently granted.

No.

IN THE
Supreme Court of the United States

BARINGS LLC, ET AL.,

Petitioners,

v.

AG CENTRE STREET PARTNERSHIP, ET AL.,

Respondents.

**On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit**

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

In *Harrington v. Purdue Pharma L.P.*, 603 U.S. 204 (2024), this Court held certain provisions in a confirmed Chapter 11 bankruptcy plan unlawful and then vacated the order confirming the plan and remanded for further proceedings in which creditors would be afforded a fresh opportunity to vote on the new plan conforming to this Court's ruling. Because the order confirming the *Purdue Pharma* plan had been stayed pending appeal, the plan had not been consummated, and this Court accordingly did not address the question whether, when an appellate court invalidates material provisions of a fully consummated bankruptcy plan, creditors must be afforded an opportunity to renegotiate and vote on a conforming bankruptcy plan. See *id.* at 226. The question presented here is the question left unanswered by *Purdue Pharma*—an issue of critical importance to participants in Chapter 11 bankruptcies and on which the circuits are divided:

Whether an appellate court can materially alter a consummated plan of reorganization without permitting a new vote of creditors or whether a material alteration by an appellate court requires a vacatur of the order confirming the plan and a new creditor vote.

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

Petitioners Barings LLC, Boston Management and Research, Inc., Eaton Vance Management, Invesco Senior Secured Management, Inc., and UBS Asset Management (Americas) LLC (as successor in interest to Credit Suisse Asset Management LLC)¹ were intervenors-appellees in the court of appeals and parties in interest in the bankruptcy court.²

Barings LLC is a wholly-owned subsidiary of MM Asset Management Holding LLC, which is a wholly-owned subsidiary of MassMutual Holding LLC, which, in turn, is a wholly-owned subsidiary of Massachusetts Mutual Life Insurance Company. Massachusetts Mutual Life Insurance Company has no parent company, and no publicly held corporation has an ownership interest in 10% or more of Massachusetts Mutual Life Insurance Company's stock.

Boston Management and Research, Inc. is a wholly-owned subsidiary of Eaton Vance Management, which is a wholly-owned subsidiary of Morgan Stanley Capital Management, LLC, which, in turn, is a wholly-owned subsidiary of Morgan Stanley, a publicly traded corporation. Morgan Stanley has no par-

¹ In the courts below, Credit Suisse Asset Management LLC was a named party. That entity has been merged with and into UBS Asset Management (Americas) LLC.

² Except where noted, the parties to this proceeding were parties listed on the dockets of the court of appeals that are at issue in this petition, Nos. 23-20363 and 23-20451, which sought review of the bankruptcy court's confirmation order. Those appeals were decided alongside the appeals from the adversary proceeding, Nos. 23-20181 and 23-20450, which had additional parties that are not listed here.

ent company; based on Securities and Exchange Commission rules regarding beneficial ownership, Mitsubishi UFJ Financial Group, Inc., 4-5, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-8330, beneficially owns greater than 10% of Morgan Stanley's outstanding common stock.

Eaton Vance Management is a wholly-owned subsidiary of Morgan Stanley Capital Management, LLC, which, in turn, is a wholly-owned subsidiary of Morgan Stanley, a publicly traded corporation. Morgan Stanley has no parent company; based on Securities and Exchange Commission rules regarding beneficial ownership, Mitsubishi UFJ Financial Group, Inc., 4-5, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-8330, beneficially owns greater than 10% of Morgan Stanley's outstanding common stock.

Invesco Senior Secured Management, Inc. is a wholly-owned subsidiary of Invesco Advisers, Inc., which, in turn, is a wholly-owned subsidiary of Invesco Group Services, Inc., which, in turn, is a wholly-owned subsidiary of OppenheimerFunds, Inc., which, in turn, is a wholly-owned subsidiary of Oppenheimer Acquisition Corporation, which, in turn, is a wholly-owned subsidiary of Invesco Holding Company (US), Inc., which, in turn, is a wholly-owned subsidiary of Invesco Holding Company Limited, which, in turn, is a wholly-owned subsidiary of Invesco Ltd., a publicly traded corporation. Invesco Ltd. has no parent company; based on Securities and Exchange Commission rules regarding beneficial ownership, BlackRock, Inc., The Vanguard Group, and Massachusetts Mutual Life Insurance Company each owns greater than 10% of Invesco Ltd.'s outstanding common stock.

UBS Asset Management (Americas) LLC (as successor in interest to Credit Suisse Asset Management

LLC) is a wholly-owned subsidiary of UBS Americas Inc., which, in turn, is a wholly-owned subsidiary of UBS Americas Holding LLC, which, in turn, is a wholly-owned subsidiary of UBS AG, which, in turn, is a wholly-owned subsidiary of UBS Group AG. UBS Group AG has no parent company, and no publicly traded corporation owns 10% or more of UBS Group AG's stock.

Respondent Citadel Equity Fund Ltd. was an appellant in the court of appeals and a party in interest in the bankruptcy court.

Respondents AG Centre Street Partnership L.P., AG Credit Solutions Non-ECI Master Fund, L.P., AG Super Fund Master, L.P., AG SF Master (L), L.P., Silver Oak Capital, L.L.C., Ascribe III Investments, LLC, Columbia Cent CLO 21 Limited, Columbia Cent CLO 27 Limited, Columbia Floating Rate Fund, a series of Columbia Funds Series Trust II, Columbia Strategic Income Fund, a series of Columbia Funds Series Trust I, Contrarian Capital Fund I, L.P., Contrarian Distressed Debt Fund, L.P., Contrarian Centre Street Partnership, L.P., Gamut Capital SSB, LLC, North Star Debt Holdings, L.P., Shackleton 2013-III CLO, Ltd., Shackleton 2013-IV-R CLO, Ltd., Shackleton 2014-V-R CLO, Ltd., Shackleton 2015-VII-R CLO, Ltd., Shackleton 2017-XI CLO, Ltd., Z Capital Credit Partners CLO 2018-1 Ltd., and Z Capital Credit Partners CLO 2019-1 Ltd. were appellants in the court of appeals and parties in interest in the bankruptcy court.

Respondent Serta Simmons Bedding, LLC was an appellee in the court of appeals and the debtor in the bankruptcy court.

Respondents Dawn Intermediate, LLC, Serta International Holdco, LLC, National Bedding Company L.L.C., SSB Manufacturing Company, The Simmons Manufacturing Co., LLC, Dreamwell, Ltd., SSB Hospitality, LLC, SSB Logistics, LLC, Simmons Bedding Company, LLC, Tuft & Needle, LLC, Tomorrow Sleep LLC, SSB Retail, LLC, and World of Sleep Outlets, LLC were also appellees in the court of appeals and debtors in the bankruptcy court.

Respondents LCM XXII Ltd., LCM XXIII Ltd., LCM XXIV Ltd., LCM XXV Ltd., LCM 26 Ltd., LCM 27 Ltd., LCM 28 Ltd. appeared as intervenors in the court of appeals in No. 23-20363 but did not participate in that appeal; they participated only in the appeals from the adversary proceeding. They were parties in interest in the bankruptcy court.

STATEMENT OF RELATED PROCEEDINGS

Pursuant to this Court's Rule 14.1(b)(iii), the following proceedings are related to this case:

- *In re Serta Simmons Bedding, LLC*, No. 23-bk-90020 (Bankr. S.D. Tex.) (judgment entered June 14, 2023);
- *Serta Simmons Bedding, LLC, et al. v. AG Centre Street Partnership L.P.*, No. 23-ap-9001 (Bankr. S.D. Tex.) (judgment entered June 14, 2023);
- *In re Serta Simmons Bedding, LLC*, No. 23-cv-2173 (S.D. Tex.) (motion to stay denied June 29, 2023);
- *Excluded Lenders v. Serta Simmons Bedding, LLC, et al.*, No. 23-20181 (5th Cir.) (judgment entered Dec. 31, 2024);
- *Citadel Equity Fund, Ltd. v. Serta Simmons Bedding, LLC, et al.*, No. 23-20363 (5th Cir.) (judgment entered Dec. 31, 2024);
- *Ad Hoc Group of Non-PTL Lenders, et al. v. Serta Simmons Bedding, LLC, et al.*, No. 23-20450 (5th Cir.) (judgment entered Dec. 31, 2024);
- *Excluded Lenders v. Serta Simmons Bedding, LLC*, No. 23-20451 (5th Cir.) (judgment entered Dec. 31, 2024).

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Barings LLC, Boston Management and Research, Inc., Eaton Vance Management, Invesco Senior Secured Management, Inc., and UBS Asset Management (Americas) LLC respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The opinion of the court of appeals is reported at 125 F.4th 555 (App. 1a-62a). The order of the court of appeals denying rehearing is unpublished (App. 169a-172a). The bankruptcy court's order confirming the plan of reorganization is unpublished (App. 99a-168a), and the bankruptcy court's opinion explaining its rationale for that order is available at 2023 WL 3855820 (App. 63a-98a).

JURISDICTION

The court of appeals entered judgment on December 31, 2024. A timely petition for rehearing en banc was denied on February 18, 2025. App. 169a. On May 1, 2025, Justice Alito granted petitioners' application to extend the time to file this petition to and including June 18, 2025. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant statutory provisions are reproduced in the appendix. App. 322a-331a.

INTRODUCTION

Chapter 11 bankruptcies often involve hundreds, if not thousands, of parties and billions of dollars. The bankruptcy here, for example—of the mattress manufacturer Serta Simmons Bedding, LLC—concerned several hundred creditors and had \$2.3 billion dollars at issue. Given the stakes, the plans of reorganization that arise from such bankruptcy processes are carefully negotiated, hard-fought, and frequently subject to extensive litigation.

In bankruptcy court, a plan cannot be confirmed if any provision of it is deemed unlawful—a determination that is typically made following objections by creditors. 11 U.S.C. § 1129(a)(1)-(3). But if a plan is confirmed by the bankruptcy court over the objections of creditors and a material provision of the plan is later deemed unlawful on appeal, the question arises whether the appellate court can blue-pencil the plan, rewriting the parties’ agreement itself to conform to the law, or instead must vacate the confirmation order and send the parties back to the drawing board.

In *Harrington v. Purdue Pharma L.P.*, 603 U.S. 204 (2024), this Court ruled that an “essential” provision in a confirmed Chapter 11 bankruptcy plan was unlawful, reversed confirmation, and remanded for the parties to renegotiate the plan. *Id.* at 227; *id.* at 229 (Kavanaugh, J., dissenting). The Court thus substantially answered the question of remedy. But *Purdue Pharma* involved a confirmed plan that had been stayed pending appeal, and the Court cabined its holding to that circumstance, explicitly reserving the question “whether [its] reading of the bankruptcy code would justify unwinding reorganization plans that

have already become effective and been substantially consummated.” *Id.* at 226.

This petition presents that follow-on question. Given the import of this remedial issue, which, as the Court has already recognized, is of vital significance to both debtors and creditors, as well as the courts reviewing confirmed bankruptcy plans on appeal, the Court should answer this outstanding question now.

The majority of circuits to address the issue, including the First, Second, Third, and Fourth Circuits, have concluded it is improper for an appellate court to rewrite a confirmed plan on appeal when a material provision is deemed unlawful without giving the parties a chance to renegotiate. But in a series of cases, the Fifth Circuit has reached the opposite conclusion—holding that it “may ‘fashion whatever relief’ it deems ‘practicable’ for the benefit of appellants.” App. 61a (quoting *In re Scopac*, 649 F.3d 320, 322 (5th Cir. 2011)). Thus, in this case, although the Fifth Circuit apparently recognized that an indemnity provision it deemed unlawful was material to the confirmed plan (the “Plan”)—it credited the testimony of “multiple witnesses * * * that they would not have voted in favor of the plan without the settlement indemnity,” App. 17a—it excised the indemnity from the Plan, rewriting the confirmed Plan without affording any creditor the opportunity to revote or renegotiate in light of the revision, App. 61a.

That decision cannot be squared with the Bankruptcy Code or established interpretive principles. The “Chapter 11 process relies on creditors and equity holders”—not courts—“to engage in negotiations toward resolution of their interests.” *Bank of America National Trust & Savings Ass’n v. 203 North LaSalle*

Street Partnership, 526 U.S. 434, 458 n.28 (1999). The Bankruptcy Code provides a carefully reticulated scheme whereby creditors negotiate their claims with the debtor, culminating in a plan of reorganization. The Code sets forth specific rules for solicitation and acceptance of creditor votes on a proposed plan. 11 U.S.C. § 1129(a)(7). Creditors must be afforded notice and the opportunity to accept or reject any modifications to a plan affecting their interests both before and after confirmation in bankruptcy court. *Id.* § 1127(a)-(d). Allowing an appellate court to do what a bankruptcy court cannot—materially rewrite a confirmed bankruptcy plan on its own without giving the creditors a chance to change their votes—runs afoul of the principles enshrined in the Bankruptcy Code.

The Fifth Circuit's approach also cannot be squared with standard principles of contract interpretation. A confirmed bankruptcy plan is treated as a contract between the debtor and its creditors. 8 Collier on Bankruptcy § 1142.04[2] (16th ed. 2025). When a court deems a contract provision unenforceable, it must conduct a severability analysis to determine whether the offending provision was critical to the parties' bargain, making the entire contract unenforceable, or whether the provision can be struck, leaving the remainder of the agreement in force. See Restatement (Second) of Contracts § 184 cmt. a (1981).

Courts addressing this remedial issue in the context of a confirmed bankruptcy plan have repeatedly looked to principles of severability, including the presence or absence of a severability clause in the plan, to determine whether a provision can be excised from the plan. The Fifth Circuit failed to conduct any such

analysis here, ignoring the many textual indicators of the indemnity's materiality to the Plan, including a nonseverability provision, as well as trial testimony and the findings of the bankruptcy court establishing that the indemnity was "essential to the Plan." App. 122a.

The Fifth Circuit thus has placed itself in conflict with the other circuits and at odds with the Bankruptcy Code. The question of what remedial relief an appellate court should enter when it holds a confirmed plan provision unenforceable is both recurring and important; its answer is critical to creditors and debtors alike in all bankruptcy cases. The Court should grant the petition.

STATEMENT

A. Statutory Background

"Under Chapter 11, the debtor can work with its creditors to develop a reorganization plan governing the distribution of the estate's assets; it must then present that plan to the bankruptcy court and win its approval." *Purdue Pharma*, 603 U.S. at 214. This system furthers Congress's view that creditors "are very often better judges of the debtor's economic viability and their own economic self-interest than courts." *Bank of America National Trust & Savings Ass'n*, 526 U.S. at 457 n.28. The negotiation process is "the essence of the formulation of any plan of reorganization." 7 Collier on Bankruptcy § 1127.03[1].

A "prerogative" of certain creditors is the ability to vote on a proposed plan. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207 (1988). To structure the voting process, Chapter 11 plans divide creditors into classes with "substantially similar" claims. 11 U.S.C.

§ 1122(a). The plan must “specify” whether each class is “impaired,” *id.* § 1123(a)(2)-(3), meaning that the claims of those creditors are affected by the plan. Only holders of impaired claims are entitled to vote on whether a plan is approved.

The voting process typically begins with circulation of a disclosure statement, 11 U.S.C. § 1125(b), which must describe the consequences of the plan such that “a hypothetical investor of the relevant class [can] make an informed judgment about the plan,” *id.* § 1125(a)(1). Once the bankruptcy court approves the disclosure statement, the proponent of the plan may solicit “acceptance or rejection” of it. *Id.* § 1125(b).

Although the plan proponent “may modify such plan at any time before confirmation,” 11 U.S.C. § 1127(a), the proponent must distribute a new disclosure statement and call for another round of voting if a modification “adversely affect[s] the treatment of any creditor under the plan * * * in more than a purely ministerial, *de minimis* manner,” 7 Collier on Bankruptcy § 1127.03[1][b].

The final step in a Chapter 11 bankruptcy is confirmation of the plan. “Once the bankruptcy court issues an order confirming the plan, that document binds the debtor and its creditors going forward.” *Purdue Pharma*, 603 U.S. at 214. Section 1127(b) of the Code allows modifications after that point only if the modified plan is consistent with “section 1129,” which contains the processes for creditor voting. 11 U.S.C. § 1127(b); see 11 U.S.C. § 1129(a)(7)-(8), (10). And modifications to a confirmed plan are permitted only “until substantial consummation of the plan.” 7 Col-

lier on Bankruptcy ¶ 1101.02[1][a]. Substantial consummation occurs when the property proposed for transfer under the plan has been conveyed, the debtor has assumed management of the reorganized entity, and distributions to creditors have commenced in accordance with the plan's terms. 11 U.S.C. § 1101(2); see Karen Visser, Chapter 11 Reorganizations § 15:10 (2d ed. 2025) (substantial consummation is “[a] term of art unique to bankruptcy”).

B. The Present Controversy

1. Serta Simmons Bedding, LLC is an American manufacturer of mattresses and other bedding products. App. 3a. In 2016, Serta entered into a credit agreement with various lenders. That agreement generally required loan payments to be made to each lender pro rata, but it carved out payments made via Serta's repurchase of its own debt through “open market purchases,” a term undefined by the credit agreement. In 2020, as COVID-19 threatened Serta's financial health, the company solicited lenders for a debt reduction transaction. The two best offers proposed that Serta lower its debt load through open market purchases of its debt at a discount.

Serta eventually chose the proposal offered by a group of lenders that included lenders managed by petitioners here (“Petitioning Lenders”). Under that proposal, Serta received \$200 million in new financing, see Record on Appeal at 24520, *Citadel Equity Fund, Ltd. v. Serta Simmons Bedding, LLC*, No. 23-20363 (5th Cir.) (“CA5 ROA”), and purchased \$1.2 billion of the lenders' existing 2016 loans with \$875 million in new, superiority loans, *id.* at 23267. Serta and the Petitioning Lenders signed a credit agreement

governing those new, superpriority loans that, among other things, indemnified the lenders receiving the loans for “all losses, claims, damages and liabilities” arising from the transaction. *Id.* at 24642-43.

Both the unsuccessful lender group, led by Apollo and Angelo Gordon (the “Competing Lenders”), and LCM, who had not participated in the transaction or the preceding negotiations, immediately challenged the transaction. Between 2020 and 2022, they filed four lawsuits arguing, among other things, that the transaction was an improper use of the open market purchase provision of the 2016 credit agreement. See *North Star Debt Holdings, L.P. v. Serta Simmons Bedding, LLC*, No. 652243/2020 (N.Y. Sup. Ct.); *LCM XII Ltd. v. Serta Simmons Bedding, LLC*, No. 20-cv-5090 (S.D.N.Y.); *LCM XXII Ltd. v. Serta Simmons Bedding, LLC*, No. 21-cv-3987 (S.D.N.Y.); *AG Centre Street Partnership L.P. v. Serta Simmons Bedding, LLC*, No. 654181/2022 (N.Y. Sup. Ct.).

In 2022, Serta contacted multiple lenders to engage in restructuring discussions. Serta entered negotiations with a group led again by the Petitioning Lenders. After months of diligence sessions and term-sheet exchanges, CA5 ROA 1309, Serta decided to file for Chapter 11 bankruptcy, and Serta and the negotiating creditors agreed on a proposed plan of reorganization. Serta filed its Chapter 11 petition and the proposed plan in January 2023. *Id.* at 4232-36 (petition), 4658-4717 (plan). The proposed plan placed holders of the superpriority loans issued in 2020 in Classes 3 and 4, while the remaining holders of the 2016 loans were placed in Class 5. *Id.* at 15698-99.

To protect the Petitioning Lenders against the continuing litigation challenging the 2020 transaction, the initial plan proposed that the 2020 credit agreement's indemnity would "survive [bankruptcy] unimpaired and unaffected." CA5 ROA 4699. In addition, Serta and the lenders supporting the plan initiated an adversary proceeding to resolve whether the 2020 transaction constituted an open market purchase under the 2016 agreement. *Id.* at 4922-48.

At summary judgment in the adversary proceeding, the bankruptcy court ruled that the 2020 transaction was an "open market purchase" permitted by the contract. CA5 ROA 2327-29. But the court held for trial the question whether the transaction violated the implied covenant of good faith and fair dealing. *Ibid.*

Before the joint trial on that claim, the defendants' counterclaims and third-party claims, as well as confirmation of the plan, the solicitation agent announced that 98.65% of Class 3 and 97.97% of Class 4 had voted in favor of the plan. App. 83a. Other creditors objected that the indemnity provision was a contingent claim disallowed by 11 U.S.C. § 502(e). In response, Serta modified the indemnity to cover only members of Classes 3 and 4, which constituted all holders of the superpriority loans issued under the 2020 credit agreement who were entitled to receive consideration in exchange for their claims under the plan. CA5 ROA 18748.

At trial, proponents of the plan testified about the importance of the indemnity provision, which the Petitioning Lenders viewed as critical given the ongoing suits and potential liability from the 2020 transaction.

Witnesses from the Petitioning Lenders uniformly testified that they would not have voted in favor of the plan absent the indemnity. CA5 ROA 3424:22-3454:4, 3477:20-23, 3514:15-17, 3551:1-3. One of Serta's independent directors testified similarly: "[I]f we did not do the indemnity today, I don't think we would have a confirmable plan." *Id.* at 3223:1-3.

The plan contained multiple terms protecting the voting rights of the supporting creditors and confirming the interdependency of its provisions, including the indemnity. A nonseverability provision specified that upon confirmation, "each term and provision of the Plan" shall be treated as "(a) valid and enforceable * * * (b) integral to the Plan * * * and (c) nonseverable and mutually dependent." App. 315a. The plan also expressly stated that any modifications were "[s]ubject to the applicable consent rights of the Requisite Consenting Creditors," *i.e.*, a majority of those lenders holding superpriority loans who had accepted the plan. App. 313a, 207a. Similarly, execution of the plan documents containing the indemnity, which were also subject to the "approval" of the Consenting Creditors, App. 183a, 186a, was a condition precedent to the plan's effectiveness, App. 286a.

After trial, the bankruptcy court confirmed the Plan, holding that the indemnity was "essential" and "an integral part" of the Plan. App. 122a. The court also reiterated its summary-judgment decision that the 2020 transaction was an open market purchase. App. 91a-92a.

The Competing Lenders and Citadel Equity Fund Ltd. ("Citadel"), a holder of Class 4 loans who objected to the indemnity provision in the Plan, appealed the

confirmation order. The bankruptcy court certified that order for direct appeal to the Fifth Circuit. CA5 ROA 26215; see 28 U.S.C. § 158(d)(2)(A). All parties jointly certified the bankruptcy court's final judgment for direct appeal. CA5 ROA 26214. The Fifth Circuit consolidated the various appeals, including separate appeals from the adversary proceeding, for oral argument.

Meanwhile, Citadel and the Competing Lenders sought stays of the confirmation order before the bankruptcy court, the district court, and the Fifth Circuit. All three courts denied those requests. CA5 ROA 3959-60 (bankruptcy court), 4076-95 (district court), 4108-09 (Fifth Circuit). The Plan became effective on June 29, 2023, and was substantially consummated on the same day.

2. A Fifth Circuit panel reversed the bankruptcy court's conclusion that the indemnity was permissible under the Bankruptcy Code. The panel reasoned that claims based on the 2020 indemnity were contingent claims for reimbursement disallowed by 11 U.S.C. § 502(e)(1)(B). App. 53a. The panel then concluded that the Plan's indemnity, though distinct from the 2020 indemnity with regard to the lenders indemnified and the time period covered, was, "for all intents and purposes, the same as or similar to that which was disallowed before." App. 57a. Although Serta and the Petitioning Lenders argued the indemnity was authorized as part of a settlement of the claims of Classes 3 and 4 under 11 U.S.C. § 1123(b)(3)(A), the panel disagreed, concluding that the provision "does not affirmatively provide for the back-end resurrection of claims already disallowed on the front end." App. 55a.

Alternatively, the panel also concluded that the settlement violated the equal-treatment requirement of 11 U.S.C. § 1123(a)(4). App. 59a.

As the remedy for this violation, the panel chose “to excise the offending indemnity” from the Plan. App. 61a. The panel determined that it could enter this “surgica[l]” relief “without unwinding the entire Plan and triggering a whole new confirmation proceeding.” App. 48a. At no point did the panel consider, consult, or cite the Plan’s provisions that prohibited piecemeal modifications of the Plan without input from the supporting creditors. And although the panel credited testimony from the Petitioning Lenders “assert[ing] that they would not have voted in favor of the plan without the [plan] indemnity,” App. 17a, the panel did not consider or even mention that testimony in analyzing whether excision was an appropriate remedy.

In the appeals from the adversary proceeding, the panel held that the “open market purchase” provision in the 2016 credit agreement did not encompass the 2020 transaction. App. 43a. With the indemnity stricken but Serta’s plan of reorganization otherwise undisturbed, the Petitioning Lenders now face potential exposure to the Competing Lenders’ claims for breach of the 2016 credit agreement—a potential liability the Petitioning Lenders had successfully bargained for Serta to take on as part of the negotiations over the Plan.

The panel denied rehearing, and the Fifth Circuit denied rehearing en banc. App. 172a.

REASONS FOR GRANTING THE PETITION

I. THE FIFTH CIRCUIT’S DECISION CONFLICTS WITH DECISIONS OF OTHER CIRCUITS.

The Fifth Circuit’s decision conflicts with the decisions of its sister circuits. The First, Second, Third, and Fourth Circuits have all reasoned that appellate excision of a material provision in a consummated plan requires that the creditors revote on the plan. By contrast, the Fifth Circuit here excised a material plan provision, giving short shrift to the negotiating rights that are the “essence” of the Chapter 11 process. 7 Collier on Bankruptcy § 1127.03[1]. Only the Ninth Circuit has come close to the Fifth Circuit, though even it stopped short, merely concluding that some form of relief apart from revoting on a plan is theoretically possible.

This Court should grant certiorari to resolve the conflict among the circuits on the important question presented here. These courts—the First, Second, Third, Fourth, Fifth, and Ninth Circuits—accounted for about 91% of new bankruptcy appeals in 2024; thus, there is no need to wait for other circuits to address the issue. See Federal Judicial Center, U.S. Courts of Appeals—Cases Commenced, Terminated, and Pending, by Circuit and Nature of Proceeding (Mar. 31, 2025), <https://www.uscourts.gov/data-news/data-tables/2025/03/31/federal-judicial-caseload-statistics/b-1>. Until this Court provides clarity, appellate courts will continue to struggle with what relief to enter when they find plan provisions unlawful, and bankruptcy parties will remain uncertain about the sanctity of their negotiated resolutions.

A. The “essence of the formulation of any plan of reorganization” is the negotiation process, which is enshrined in the Bankruptcy Code. 7 Collier on Bankruptcy § 1127.03[1]. A confirmed plan is “primarily the product of negotiations between the debtor and creditors.” *Truck Insurance Exchange v. Kaiser Gypsum Co.*, 602 U.S. 268, 272 (2024). The “Code provides that it is up to the creditors—and not the courts—to accept or reject a reorganization plan.” *Norwest Bank Worthington*, 485 U.S. at 207. Since the Code treats approval of a plan as the “prerogative” of creditors, that determination “is for the creditors to make in the manner specified by the Code.” *Ibid.* “[C]ourts applying the Code must effectuate their decision.” *Ibid.*

Given the high value accorded to the parties’ negotiations, the majority of courts—including the First, Second, Third, and Fourth Circuits—have declined to materially modify a bankruptcy plan on appeal without giving the creditors a chance to revote in accordance with the Code.

For example, in *In re Charter Communications, Inc.*, 691 F.3d 476 (2d Cir. 2012), objectors, who had lost in bankruptcy court, asked the Second Circuit to rewrite a “prenegotiated” settlement between the debtor and its main creditor that was the “cornerstone” of the consummated plan. *Id.* at 480. Although the objectors argued that the Second Circuit could revise the settlement by “surgically excis[ing]” third-party releases and modifying payments under the settlement without unwinding confirmation, the Second Circuit rejected that proposal. *Id.* at 484. The court concluded that because the settlement was “critical to the bargain,” “undoing” it “would cut the heart out of the reorganization,” making “a quick, surgical change

to the confirmation order” impossible. *Id.* at 486. The settlement was “the product of an intense multi-party negotiation,” and “removing a critical piece of [it] * * * would [have] impact[ed] other terms of the agreement.” *Id.* at 485. Importantly, the compromising creditor might “not be willing to give up the benefit he received * * * without also reneging on at least part of the benefit he bestowed.” *Id.* at 486. Necessarily, then, excising portions of the settlement would require the parties “to enter renewed negotiations” and “reopened” bankruptcy proceedings. *Id.* at 486 & n.5.

Other circuits have agreed. In *In re Tribune Media Co.*, 799 F.3d 272 (3d Cir. 2015), the Third Circuit concluded that severing a settlement that was “a central issue in the formulation of [the] plan” and a “crucial component” of the consummated plan would “recall the entire Plan for a redo.” *Id.* at 274, 280-81. And the Third Circuit applied the “same reasoning from *Tribune* * * * with great force” in *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126 (3d Cir. 2019). There the court rejected the argument that it could revise a consummated plan by striking “essential” third-party releases “only as to [the objector].” *Id.* at 141-42. The Third Circuit explained that given the centrality of the releases to the plan’s funding, such excision would cause the “plan to collapse,” necessitating a “do-over.” *Ibid.*³

³ In *Purdue Pharma*, this Court abrogated *Millennium*’s holding that the Code allows nonconsensual releases of claims against third-party debtors. See 603 U.S. at 214 n.1. But *Purdue Pharma* did not disturb *Millennium*’s analysis regarding excision; rather, in *Purdue Pharma* (although it did not involve a substantially consummated plan, as in *Millennium* and this

The Third Circuit further observed that judicial blue-penciling of the releases in *Millennium* would unfairly upend the parties' negotiations. Under the proposed revisions, the objector "would receive a windfall—at the substantial and uncompensated expense of [other parties]—if [the court] were to let it avoid the release provisions without requiring it to return the value it obtained through the reorganization." 945 F.3d at 143. In other words, the objector wanted "all of the value of the restructuring and none of the pain." *Ibid.* The resulting inequity was yet another reason why it was inappropriate for the court to simply rewrite the settlement without unwinding the plan.

The First Circuit in *In re Financial Oversight & Management Board for Puerto Rico*, 989 F.3d 123 (1st Cir. 2021), likewise concluded that it could not rewrite a plan on appeal without sending the parties back to the drawing board. At issue in *Puerto Rico* were debtor releases that objecting creditors sought to strike from the consummated plan. *Id.* at 128-29. But the First Circuit ruled that those releases were "a fundamental component of the Plan" and part of the "compromises and settlements * * * inextricably interwoven" in the plan, which "all hinge[d] on one another." *Id.* at 133. As a result, the court could not simply "tweak" the plan nor "compel" the debtor "to accept the Plan without the release of all claims against it." *Ibid.* Rather, the only decision on appeal

case), the Court agreed with the Third Circuit—invalidation of the third-party releases necessitated a redo of confirmation. *Id.* at 227.

was an “up-or-down” vote: “affirm” the plan as negotiated or “vacate Plan approval,” unwinding the plan and reopening confirmation proceedings. *Ibid.*

Similarly, in *In re U.S. Airways Group, Inc.*, 369 F.3d 806 (4th Cir. 2004), the Fourth Circuit agreed that material modifications to a consummated plan on appeal require a revote by creditors. The appellant there sought to reverse the termination of a pension plan that was “a necessary condition” to confirmation of the bankruptcy plan. *Id.* at 811. Reversal “would essentially ‘unsatisfy’” the condition. *Ibid.* Once that occurred, “other parts of the plan would have to be re-configured,” and those changes would require “approval by [the debtor]’s lenders.” *Ibid.*

All of these circuits thus have recognized that it is improper to make material changes to a confirmed plan without giving the parties a chance to renegotiate. Although these decisions went on to apply the doctrine of equitable mootness because the courts were ultimately hesitant to disturb confirmation, the appropriate remedy if a plan provision is deemed invalid is a threshold question that arises irrespective of equitable mootness considerations. It suffices that these other circuits declined to blue-pencil a confirmed plan; the Court need not address whether the next step, after concluding that it is improper to rewrite a confirmed plan on appeal, is to dismiss under the equitable mootness doctrine or vacate for a revote.

B. Against that backdrop, the Fifth Circuit has taken the opposite position, holding that it is appropriate to excise material portions of a plan on appeal without sending the plan back for a new vote. App. 61a-62a. In the Fifth Circuit’s view, it can “fashion

whatever relief” it deems “practicable” “[o]n review of a confirmed plan,” without affording the parties the opportunity to redo confirmation. App. 61a (quoting *In re Scopac*, 649 F.3d 320, 322 (5th Cir. 2011), and *In re Pacific Lumber Co.*, 584 F.3d 229, 241 (5th Cir. 2009)). Thus, the Fifth Circuit in this case rejected contentions that it could not “excise the indemnity” challenged by objectors “without unwinding the entire Plan and triggering a whole new confirmation proceeding.” App. 48a. Instead, under the Fifth Circuit’s approach, an appellate court can blue-pencil confirmed plans as it sees fit.

Unlike the other circuits, the Fifth Circuit dismissed concerns about upsetting the parties’ careful negotiations or imposing a plan that neither the debtor nor creditors created. The Fifth Circuit below was untroubled “about depriving a creditor of the benefits of its bargain,” because it viewed plan revisions as a natural consequence of appeal. App. 51a. Thus, although the court observed that “multiple witnesses * * * asserted that they would not have voted in favor of the plan without the settlement indemnity,” App. 17a, the court concluded that an adverse appellate result should have been “foreseeable to them as sophisticated investors,” App. 52a. And the Fifth Circuit rejected arguments that it was “unfair for t[he] court to excise the indemnity [on appeal] without letting [the parties] go back to the drawing board,” or that the court “cannot excise specific provisions but must let the parties go back to square one.” App. 50a-51a.

Instead, the court viewed Fifth Circuit precedent as requiring “just the opposite”—“explicitly rejecting

the notion that the court cannot surgically excise certain provisions rather than unravel the entire plan.” App. 48a (citing *In re Highland Capital Management, L.P.*, 48 F.4th 419, 430 (5th Cir. 2022)); see *ibid.* (“our precedents does [sic] not indicate that the remedy of excision requires” “the unraveling of the Plan”). Thus, the Fifth Circuit built on its earlier decisions holding it proper to excise provisions from confirmed plans on appeal without triggering a revote. See *Highland Capital Management*, 48 F.4th at 430-31, 438 (rewriting exculpation provisions, despite arguments that the altered “provisions [were] ‘integral to the consummated plans’”); *Pacific Lumber*, 584 F.3d at 252-53 (striking “non-consensual non-debtor releases” while rejecting arguments that “release clause [was crucial] part of [the parties’] bargain”). Accordingly, the Fifth Circuit here chose “to excise the offending indemnity” without offering a revote. App. 61a.

The Fifth Circuit’s approach cannot be reconciled with that of the First, Second, Third, and Fourth Circuits. The Fifth Circuit engaged in precisely the kind of “quick, surgical change” that the Second Circuit rejected in *Charter Communications*, 691 F.3d at 486, and the material “tweak” that the First Circuit rejected in *Puerto Rico*, 989 F.3d at 133. Unlike the Fifth Circuit, these other circuits have held that material modifications require a “do-over” of confirmation, *Millennium*, 945 F.3d at 141, including obtaining the requisite “approval” from lenders, *U.S. Airways Group, Inc.*, 369 F.3d at 811.

C. Only the Ninth Circuit has come close to the Fifth Circuit’s position. In *In re Transwest Resort Properties, Inc.*, 801 F.3d 1161, 1171-73 (9th Cir.

2015), the Ninth Circuit concluded that it was theoretically possible to “devise” “potential options for relief * * * that could be provided without unravelling the plan,” including modifying a plan provision or imposing monetary remedies. Nonetheless, the Ninth Circuit did not impose such a remedy itself but remanded for the district court to consider the merits of the claims. *Id.* at 1173. And elsewhere, the Ninth Circuit has recognized that by “knocking the props out from under the plan,” material modifications to a confirmed plan “would require * * * a new vote on the plan.” *In re CPESAZ Liquidating, Inc.*, 2023 WL 7411536, at *1 (9th Cir. Nov. 9, 2023).

* * *

The circuits are divided over whether a revote is required when a court materially modifies a plan on appeal—and the Fifth Circuit stands as an outlier against the considered jurisprudence of four circuits, which, combined with the Fifth Circuit, hear the majority of bankruptcy appeals. The Court should resolve this fundamental dispute over the proper appellate remedies on review of a consummated bankruptcy plan.

II. THE FIFTH CIRCUIT’S DECISION IS WRONG.

Review is also warranted because the decision below defies the Code and established legal interpretive principles and deprives creditors of the vote that is the heart of the Chapter 11 reorganization process. That process is designed to “brin[g] all interested parties to the bargaining table and encourag[e] them, against the background of insolvency law, to work out a plan of reorganization with which they all can live.” *LaSala v. Bordier et Cie*, 519 F.3d 121, 136 (3d Cir.

2008). Under the Fifth Circuit's approach, however, an appellate court can excise an essential provision of that plan and bind creditors to what remains of the plan, without affording them the opportunity to renegotiate or revote on the reworked plan.

That is wrong. Both the Bankruptcy Code and background principles of contract law protect parties from being subjected against their will to a bargain materially different from the one to which they agreed. Courts should not be permitted to blue-pencil a confirmed plan on appeal.

A. The Decision Below Conflicts With The Bankruptcy Code's Mandate To Secure Creditor Assent To Material Plan Modifications.

The decision below sits sharply at odds with the Bankruptcy Code's carefully calibrated voting system for Chapter 11 plans, which empowers creditors to approve or reject material changes to the plan. Under the Code, a plan cannot be confirmed unless a sufficient share of the creditors accepts it. See 11 U.S.C. § 1129(a)(7)-(10); see also *id.* § 1126(c)-(d). And the Code protects the negotiating rights of the parties by providing that creditors have a right to vote on material changes to the plan made in bankruptcy court.

After a plan has been proposed but before it has been confirmed, material modifications to the plan must receive sufficient affirmation from impacted creditors. Under the Code, a plan's proponent "may modify such plan at any time before confirmation," 11 U.S.C. § 1127(a), but a pre-confirmation modification that would "adversely change the treatment" of a creditor's claim requires notice to the affected creditors

and their assent to the modification, Fed. R. Bankr. P. 3019(a); see 11 U.S.C. § 1127(c)-(d). In other words, a modification that “materially and adversely affects the treatment of a class of claim or interest holders” cannot occur unless those creditors receive “a new disclosure statement and another opportunity to vote.” *In re America-CV Station Group, Inc.*, 56 F.4th 1302, 1305 (11th Cir. 2023); accord 7 Collier on Bankruptcy ¶ 1127.03[1].

The rule for post-confirmation modifications is similar. In bankruptcy court, a plan may be modified after confirmation and before substantial consummation of the plan—but “only if * * * the court, after *notice and a hearing*, confirms such plan as modified[] under section 1129.” 11 U.S.C. § 1127(b) (emphasis added). And Section 1129 sets forth the various voting rules that must be satisfied before confirmation. See *id.* § 1129(a)(7)-(10). By incorporating those rules, Section 1127 requires that the party seeking to modify the plan provide creditors with an opportunity to vote on the change, and that the modified plan attain the same degree of creditor buy-in required to confirm a Chapter 11 plan in the first place. See *In re FCX, Inc.*, 853 F.2d 1149, 1156 (4th Cir. 1988); 11 U.S.C. § 1127(d). After substantial consummation, if the debtor is a business, a plan cannot be materially modified in bankruptcy court at all. See 11 U.S.C. § 1127(b), (e).

A bankruptcy court can confirm a plan only if it finds that the plan is lawful and lawfully proposed. 11 U.S.C. § 1129(a)(1)-(3). Thus, when a bankruptcy court deems a plan provision unlawful (unless the plan itself provides for excision, see *infra* Part II.B), the only remedy is for the court to deny confirmation,

sending the parties back to the drawing board to restart the solicitation and acceptance process all over again. See 11 U.S.C. § 1129(a)(7)-(10); 9A Collier on Bankruptcy § 3020.02[3] (“At a confirmation hearing, the court must verify that the plan meets each of the tests prescribed by section 1129 of the Code[.]”).⁴

The decision below undercuts these carefully articulated provisions—with which it never engaged. Under the Fifth Circuit’s rule, a court can reconfigure the parties’ bargain by invalidating a key provision of a plan and holding the parties to the reconstituted plan against their will—even though the excised provision was essential to securing the agreement. And although the Plan here was the product of the painstaking “negotiations between the debtor and [its] creditors” that are integral to the Chapter 11 process, *Truck Insurance Exchange*, 602 U.S. at 272, the decision below afforded creditors no opportunity to renegotiate or rescind their acceptance of the materially altered plan the Fifth Circuit devised. Far from considering the voting rights of supporting creditors, the Fifth Circuit concluded that their rights were irrelevant because they were parties to the appeal and

⁴ *E.g.*, *In re Green Pharmaceuticals, Inc.*, 617 B.R. 131, 138 (Bankr. C.D. Cal. 2020) (denying confirmation because plan provision was unlawful); *In re Homitz*, 2014 WL 3721998, at *4 (Bankr. W.D. Pa. July 24, 2014) (same); *In re Irving Tanning Co.*, 496 B.R. 644, 659 (B.A.P. 1st Cir. 2013) (affirming denial of confirmation based on unlawful plan provision); *In re Mayslake Village-Plainfield Campus, Inc.*, 441 B.R. 309, 323 (Bankr. N.D. Ill. 2010) (denying confirmation because plan provision was unlawful); *In re Bush Industries, Inc.*, 315 B.R. 292, 308 (Bankr. W.D.N.Y. 2004) (same); *In re Shin*, 306 B.R. 397, 414-15 (Bankr. D.D.C. 2004) (same); *In re Birdneck Apartment Associates, II, L.P.*, 156 B.R. 499, 506 (Bankr. E.D. Va. 1993) (same).

could have “foresee[n] the adverse consequences of an unfavorable appellate ruling.” App. 52a; see App. 47a (highlighting that the creditors “are present” in the appeal).

That outcome is fundamentally at odds with the Code, which preserves a creditor’s right to withdraw support if a plan is modified. Although Section 1127’s express terms “d[o] not place any limit on the power of the court of appeals,” “the reasons underlying” the Code’s protections for the voting rights of creditors cannot be reconciled with the Fifth Circuit’s approach. *In re UNR Industries, Inc.*, 20 F.3d 766, 769 (7th Cir. 1994) (Easterbrook, J.). Indeed, it would be a strange result if a plan could be modified prior to substantial consummation in bankruptcy court only with the consent of the creditors, but an appellate court could impose an identical modification after consummation years later without affording the creditors any opportunity to revote. The Fifth Circuit’s rule “make[s] an end run around” the Code, allowing “monkey wrenches” to be thrown “into the proceedings” that bulldoze the parties’ painstaking negotiations. *Holstein v. Brill*, 987 F.2d 1268, 1270 (7th Cir. 1993).

The proper approach instead is for an appellate court to follow the process prescribed in the Bankruptcy Code and the same approach that this Court applied in *Purdue Pharma*. See 11 U.S.C. § 1129(a)(1)-(2); *Purdue Pharma*, 603 U.S. at 227. If an appellate court deems a material plan provision invalid, then it should not rewrite the plan on its own and uphold confirmation; the only options on appeal are to affirm the plan as written or vacate plan confirmation and send the parties back to renegotiate an appropriate plan. See *Puerto Rico*, 989 F.3d at 133.

B. The Fifth Circuit’s Rule Runs Afoul Of Bedrock Severability Principles.

The decision below is also incorrect for another reason: It contradicts the contract-law principles undergirding the Bankruptcy Code, which provide that a contract cannot be enforced if a material term is invalid. Applied to the Chapter 11 context, those principles require a court to determine whether an unenforceable provision is essential to the plan and, if it is, to declare the entire plan unenforceable and send the parties back to the drawing board.

Because the Bankruptcy Code is designed to protect and effectuate the parties’ negotiations, a confirmed bankruptcy plan is treated as a contract between the debtor and its creditors. 8 Collier on Bankruptcy § 1142.04[2] (“After confirmation, the plan and any agreements necessary to effectuate the plan essentially function as contracts between the debtor and the other parties to them.”); *JCB, Inc. v. Union Planters Bank, NA*, 539 F.3d 862, 870 (8th Cir. 2008) (“Once confirmed, a Chapter 11 plan acts as * * * a contract which binds the parties.”). Thus, courts—including the Fifth Circuit—regularly “follo[w] principles of contract interpretation to interpret a confirmed plan of reorganization.” *In re FFS Data, Inc.*, 776 F.3d 1299, 1304 (11th Cir. 2015); accord, e.g., *In re Conco, Inc.*, 855 F.3d 703, 711 (6th Cir. 2017); *In re Advisory Committee of Major Funding Corp.*, 109 F.3d 219, 222 (5th Cir. 1997).

Among the “general contract principles” that inform the interpretation of a Chapter 11 plan, *In re Baroni*, 36 F.4th 958, 967 (9th Cir. 2022), is the rule

that courts reviewing a contract will not impose an entirely new bargain on the parties before them. Because a “refusal to enforce only part of the agreement will necessarily result in some inequality,” if the unenforceable provision is “essential,” “the inequality will be so great as to make the entire agreement unenforceable.” Restatement (Second) of Contracts § 184 cmt. a (1981). Thus, if a court determines that a provision of a contract is unenforceable, the court conducts a severability analysis to determine whether the invalid provision is “an essential part of the agreed exchange.” *Id.* § 184(1); see, e.g., *Ronderos v. USF Reddaway, Inc.*, 114 F.4th 1080, 1099-100 (9th Cir. 2024) (courts assess whether a provision goes to “the central purpose of the contract” (citation omitted)); *Spinetti v. Service Corp. International*, 324 F.3d 212, 222 (3d Cir. 2003) (“severability of contract provisions” depends on whether the provisions “constitut[e] the primary or essential purpose” of the contract). Where a contract is not severable, the parties get sent back to the drawing board; the court does not create a contractual chimera to bind the parties.

In evaluating severability, courts often consider the presence (or absence) of a severability clause, which provides “one indication that a particular term was important to the bargaining parties.” *Charter Communications*, 691 F.3d at 485. Other textual indicia, including the structure of the agreement and the relationships between its provisions, can also provide critical clues—since the best evidence of the parties’ understanding is the text to which they agreed. See Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 29-30 (2012) (explaining that contracts “express the parties’ intent in

a binding form”; “intent is * * * derived * * * from the words of the text”; and “words are given meaning by their context”). Beyond the text of the agreement itself, courts have also evaluated witness or documentary testimony. *E.g.*, *Charter Communications*, 691 F.3d at 486 (considering witness testimony “representing that [certain plan provisions] were important” to the negotiating parties).

These bedrock severability principles compel courts to respect the plan the parties negotiated, not impose a judicially-crafted reorganization. That is exactly what the circuits in conflict with the Fifth Circuit have correctly reasoned.

Thus, in *Puerto Rico*, the First Circuit held that the only remedial option was an “up-or-down decision * * * affirm or vacate Plan approval,” by relying on a nonseverability provision stating that the challenged provisions “constitute an essential component of the compromises reached and are not severable from the other provisions of this Plan,” as well as the lower court’s finding that the “compromises and settlements [in the plan] are inextricably interwoven.” 989 F.3d at 132-33. Similarly, in *Charter Communications*, the Second Circuit looked both to a “nonseverability clause” in the plan and to witness testimony regarding the importance of the challenged provisions, before concluding that “a quick, surgical change to the confirmation order” was impossible, and the parties “would have to enter renewed negotiations.” 691 F.3d at 485-86. And the Third Circuit in *Millennium* relied both on a “[non]severability provision” making the plan’s funding “contingent” on third-party releases, and on the bankruptcy court’s finding that the releases “were essential to the plan,” to hold that

excision of the releases “would undermine the fundamental basis for the parties’ agreement,” necessitating a “do-over of the plan.” 945 F.3d at 141.

In contrast, where a confirmed plan included an express severability clause, which provided that the plan “would remain in effect” if “*any* provision” in the plan was “determined to be unenforceable,” and the debtor failed to prove the import of a challenged release provision, the Fourth Circuit concluded that the challenged provision was “not essential.” *National Heritage Foundation, Inc. v. Highbourne Foundation*, 760 F.3d 344, 349 (4th Cir. 2014). It could thus be severed from the plan. See *ibid.*⁵

The decision below wholly disregarded the bed-rock principles these courts have faithfully applied. Although the Fifth Circuit credited the testimony of “multiple witnesses * * * that they would not have voted in favor of the plan without the settlement indemnity,” App. 17a, and took at face value Petitioning Lenders’ contention that they “agreed to support the Plan only because of the settlement indemnity,” App. 50a, the court failed to conduct a severability analysis. It considered neither the express text of the Plan, nor the evidence regarding the importance of the indemnity, before remarking that “excision does not toll doom for the Plan,” and concluding, based on its precedent, that it could excise the indemnity forthwith. App. 48a-49a, 61a.

⁵ It is precisely in this scenario, where the plan itself provides guidance, that a court can confidently sever provisions, while leaving the remainder of the plan enforceable between the parties.

In actuality, Serta's Plan—like those in *Millennium* and *Puerto Rico*—expressly stated that every provision was “nonseverable and mutually dependent.” App. 315a. The Plan further provided, similar to the conditions in the plans in *Millennium* and *U.S. Airways*, that execution of the plan documents, which included the indemnity, and the bankruptcy court's entry of a confirmation order “in form and substance acceptable to the Requisite Consenting Creditors,” were “conditions precedent” to consummation of the Plan. App. 286a-288a; see *U.S. Airways Group, Inc.*, 369 F.3d at 811. Moreover, the Plan stated that any modification “permitted by law” remains “[s]ubject to the applicable consent rights of the Requisite Consenting Creditors,” App. 313a, underscoring that creditors should be given a chance to withdraw their consent after judicial modification.

The uncontroverted trial evidence—including testimony from both Serta and the supporting creditors—was that the indemnity was crucial to the Plan. CA5 ROA 3223:1-3, 3424:22-3454:4, 3477:20-23, 3514:15-17, 3551:1-3. Accordingly, the bankruptcy court found, “based upon the record” and the “evidence presented,” that the indemnity was “an integral part” of the Plan, “essential to the Plan,” and “necessary to implement the Plan.” App. 122a. And it further found that the “provisions of the Plan * * * are nonseverable and mutually dependent,” App. 150a, and that the “compromises” and “settlements” “in the Plan,” including the indemnity, “are nonseverable from each other and from all other terms of the Plan,” App. 141a.

The Fifth Circuit's decision to ignore both the text of the Plan and the bankruptcy court's evidentiary findings not only conflicts with the approach of the

other circuits, but makes a mockery of the parties' extensive negotiations. At minimum, before ordering excision and refusing to let the parties "go back to the drawing board," App. 50a, the Fifth Circuit should have conducted a severability analysis to evaluate the importance of the indemnity to the Plan. Had the Fifth Circuit properly analyzed the remedial question, it should have held that the centrality of the indemnity provision meant that the Plan could not be enforced without it—requiring the parties to negotiate a new plan.

* * *

The Code and contract law compel the same result: An appellate court may not strike material provisions from a Chapter 11 plan without affording the creditors an opportunity to vote on the revised plan. In holding otherwise and blessing the judicial rewriting of carefully brokered agreements between debtors and creditors, the Fifth Circuit undermined the "requirement for informed suffrage which is at the heart of Chapter 11," *In re Lionel Corp.*, 722 F.2d 1063, 1066 (2d Cir. 1983), and threatened the ability of parties to effectively engage in the negotiations that "[t]he Bankruptcy Code seeks to facilitate," *America-CV*, 56 F.4th at 1308; accord *Trantham v. Tate*, 112 F.4th 223, 239 (4th Cir. 2024) (Wilkinson, J., concurring) ("[n]egotiation and collaboration among numerous parties" are "an essential ingredient in the bankruptcy process" (citation omitted)).

III. THIS CASE SQUARELY PRESENTS A SIGNIFICANT AND RECURRING QUESTION.

The question presented here is critical to bankruptcy appeals, and its answer will have significant ramifications for how creditors and debtors negotiate

and structure Chapter 11 reorganization plans. This case provides an appropriate vehicle to address the issue, since the uncontroverted evidence was that the indemnity provision was a *sine qua non* for the Plan, and the Fifth Circuit erroneously imposed a plan on the parties that they did not craft.

A. The Question Presented Is Important.

As high-stakes bankruptcies continue to capture headlines,⁶ the question of what relief courts can order in bankruptcy appeals has assumed vital significance, making it imperative for this Court to provide a single, clear rule. Chapter 11 plans, like the Plan here, often include hundreds of provisions, all carefully negotiated between the debtor and hundreds of its creditors. As occurred here, nonconsenting creditors frequently challenge individual provisions, and courts need clarity regarding what relief to order when they deem a provision unlawful on appeal, but the plan has already been consummated.

⁶ See, e.g., Jordan Valinsky, *Rite Aid Files for Bankruptcy—Again*, CNN (May 5, 2025), <https://www.cnn.com/2025/05/05/business/rite-aid-bankruptcy>; Bhanvi Satija et al., *DNA Testing Firm 23andme Files for Bankruptcy as Demand Dries Up*, Reuters (Mar. 25, 2025), <https://www.reuters.com/business/healthcare-pharmaceuticals/dna-testing-firm-23andme-files-chapter-11-bankruptcy-sell-itself-2025-03-24/>; Kate Gibson, *Vodka Maker Stoli Group Files for Bankruptcy Protection in U.S.*, CBS News (Dec. 2, 2024), <https://www.cbsnews.com/news/vodka-maker-stoli-group-bankruptcy/>; Jordan Valinsky, *TGI Fridays Files for Bankruptcy*, CNN (Nov. 2, 2024), <https://www.cnn.com/2024/11/02/food/tgi-fridays-bankruptcy/index.html>; Ayana Archie, *The Boy Scouts Are Out of Bankruptcy and Will Pay \$2.4 Billion to Sex Abuse Survivors*, NPR (Apr. 21, 2023), <https://www.npr.org/2023/04/21/1171195077/boy-scouts-bankruptcy-survivors-fund>.

The Court has already recognized the significance of the question presented here in its recent decision in *Purdue Pharma*—singling out and reserving the issue of whether invalidation of a confirmed plan provision on appeal “justif[ies] unwinding reorganization plans that have already become effective and been substantially consummated.” 603 U.S. at 226. And while *Purdue Pharma* suggested that courts should reverse confirmation when invalidating a key plan provision, *id.* at 227, the decision has only brokered confusion among the lower courts about how to address the issue, see, e.g., *In re Murray Energy Holdings Co.*, 665 B.R. 347, 358 (Bankr. S.D. Ohio 2024) (*Purdue Pharma* “does not support unwinding a substantially consummated plan or nullifying an integral element of that plan”); *Mercy Health Network, Inc. v. Mercy Hospital*, 2025 WL 1000782, at *8 (N.D. Iowa Mar. 3, 2025) (same); see also *In re Boy Scouts of America*, 137 F.4th 126, 171 n.5 (3d Cir. 2025) (Rendell, J., concurring) (citing with approval *Purdue Pharma*’s language indicating that its rule would not apply to consummated plans).

This case is the natural follow-on to *Purdue Pharma*. There, the Court considered “a stayed reorganization plan” and reversed its confirmation after ruling third-party releases unlawful, remanding “for further proceedings,” *i.e.* renegotiation of the plan, which is precisely what has occurred on remand. 603 U.S. at 226-27; see *In re Purdue Pharma L.P.*, 666 B.R. 461, 467 (Bankr. S.D.N.Y. 2024). Here, in contrast, the Fifth Circuit deemed an integral plan provision unlawful but excised it without vacating confirmation or remanding for a new creditor vote.

Purdue Pharma demonstrates that an appellate court that invalidates a plan provision should vacate confirmation, resulting in a redo, if confirmation of the plan has been stayed. But if, as the Fifth Circuit’s decision requires, a different rule governs when no stay is awarded, the decision of whether to grant a stay may have dramatic consequences for confirmation and for what the plan looks like after appellate review. This disparity invites forum shopping and makes it critical for this Court to answer the question it raised in *Purdue Pharma*.

More generally, the conflict among circuits on the question presented has profound practical stakes for debtors and creditors seeking to negotiate restructuring plans. Both creditors and debtors must be able to negotiate with assurance that their deal will hold, or that they will be given the chance to renegotiate. After all, the “essence of the formulation of any plan of reorganization” is the negotiation process. 7 Collier on Bankruptcy § 1127.03[1].

If the Fifth Circuit’s decision is allowed to stand, the result may not only be a plan that “turn[s] out to be too good a deal for the debtor’s owners”—or for its creditors, depending on what imbalance is created by the excision. *Bank of America National Trust & Savings Ass’n*, 526 U.S. at 444. The negotiation process itself also will be hampered. Creditors will be incentivized to demand more from debtors to shore up their financial interests against the risk of having their chief concessions nullified on appeal. This will result in extended and more complex negotiations that keep debtors in bankruptcy for much longer.

That, in turn, will have consequential effects on debt markets, as multiple commentators remarked in the wake of the Fifth Circuit’s decision. See, e.g., Adam Levitin, *Serta Simmons Uptier: Implications, Credit Slips* (Jan. 2, 2025), <https://www.creditslips.org/creditslips/2025/01/serta-simmons-uptier-implications.html> (predicting that the indemnity ruling will have “far-reaching implications” for debt markets); James Nani & Alex Wolf, *Serta Debt Ruling Lobs ‘Grenade’ Into Restructuring Strategies*, Bloomberg (Jan. 3, 2025), <https://news.bloomberglaw.com/bankruptcy-law/serta-debt-ruling-lobs-grenade-into-restructuring-strategies> (similar). This Court’s intervention is therefore essential to providing much-needed clarity and stability to debtors and creditors across the economy.

B. This Case Is An Excellent Vehicle For Addressing The Question Presented.

This case squarely and cleanly presents the issue of an appellate court’s remedial power in the Chapter 11 context. That question is a purely legal one that was explicitly addressed by the Fifth Circuit and is case-dispositive here. And because the case went to trial in the bankruptcy court, it comes to this Court on a full factual record. There are no outstanding factual disputes or other vehicle issues that could complicate this Court’s review. Had the Fifth Circuit conducted a severability analysis, the only conclusion it could have reached on this record was that the indemnity provision was integral to the parties’ bargain, and so the Plan could not be enforced without it. See *supra* pp. 28-30.

Importantly, the Petitioning Lenders do not contest the authority of reviewing courts to hold plan provisions unlawful or question the propriety of the equitable mootness doctrine. Contra App. 50a-51a. If a court “cannot excise specific provisions but must let the parties go back to square one,” appellate courts would not be “stripped of their jurisdiction,” as the court below feared. App. 51a. Rather, where a severability analysis indicates that a plan provision is essential, courts should have a binary choice to “affirm or vacate Plan approval,” as other circuits have correctly held. *Puerto Rico*, 989 F.3d at 133.

This case therefore presents an ideal opportunity to resolve the split among the courts of appeals on how to remedy an unlawful provision in a confirmed plan. Because the majority of circuits handling bankruptcy appeals already have addressed the issue in conflicting ways, there is no need to await further percolation in the lower courts. And because the Fifth Circuit relied on its own precedent to reach its conclusion and then declined to consider the issue en banc, there is every reason to think that the conflict among the circuits will persist unless this Court intervenes.

CONCLUSION

The petition for a writ of certiorari should be granted.

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Respectfully submitted.

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Hon. Michael A. Fagone is a U.S. Bankruptcy Judge for the District of Maine in Bangor, appointed in April 2015. He is also a member of the U.S. Bankruptcy Appellate Panel for the First Circuit, appointed in April 2016. Judge Fagone previously clerked for Associate Justices Leigh I. Saufley and Robert W. Clifford of the Maine Supreme Judicial Court. Following his clerkship, he joined Bernstein, Shur, Sawyer & Nelson in Portland, Maine, and was a member of its Business Restructuring and Insolvency Practice Group from 1998-2000, and from 2001-15, where he represented clients in bankruptcy cases and in out-of-court restructurings. While practicing law, Judge Fagone was recognized in *The Best Lawyers in America* and *Chambers USA* as one of the top bankruptcy lawyers in Maine. He is Board Certified in Business Bankruptcy Law by the American Board of Certification and served on the board of directors of the Nathan and Henry B. Cleaves Law Library, and on the board of directors of the Dyer/Library and Saco Museum. Judge Fagone currently serves on ABI's Board of Directors and volunteers with Credit Abuse Resistance Education (CARE), teaching students about the responsible use of credit and the dangers of credit abuse. He also has volunteered as a coach and an evaluator for Maine Law's teams in the Conrad B. Duberstein Moot Court Competition. Judge Fagone received his B.A. from Amherst College in 1993 and his J.D. *summa cum laude* from the University of Maine School of Law in 1997.

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tions and secured transactions. He is a scholar of bankruptcy, insolvency and the ethics of debt; his research focuses on how legal institutions can best serve our shared values during times of financial distress. Prof. Hampson has written on a wide range of topics, from benefit corporations and small business bankruptcy to imprisonment for debt. His scholarship has appeared or is forthcoming in prominent law reviews across the country, including the *Harvard Law Review*, the *Fordham Law Review*, the *Iowa Law Review* and the *American Bankruptcy Law Journal*. His work has also been cited by federal district and appellate courts, as well as two state supreme courts. Prior to joining UF Law, Prof. Hampson practiced law at Wilmer Cutler Pickering Hale and Dorr LLP in Boston, where he led litigation and transactional teams as part of the firm's bankruptcy and financial restructuring group. His bankruptcy work included blockbuster chapter 11, appellate and Supreme Court cases, as well as a \$1.6 billion securities litigation related to the Puerto Rico insolvency proceedings. His *pro bono* practice has included eviction defense and asylum applications. Prior to joining WilmerHale, Prof. Hampson clerked for Hon. Richard A. Posner on the Seventh Circuit in Chicago and worked at White & Case LLP in Miami. He received his A.B. *magna cum laude* with highest honors from Harvard College in the comparative study of religion, his J.D. *magna cum laude* from Harvard Law School, and his M.T.S. from Harvard Divinity School, where he was a Dean's Fellow. During his time at Harvard Law School, he served as articles co-chair of the *Harvard Law Review*.