AMERICAN COLLEGE OF BANKRUPTCY
2018 INDUCTION EDUCATION SESSIONS

Judges' Roundtable
Saturday March 17, 2018

Hon. Mary Grace Diehl (moderator)
United States Bankruptcy Judge
Northern District of Georgia

Hon. John E. Hoffman, Jr.
United States Bankruptcy Judge
Southern District of Ohio

Hon. Cynthia A. Norton
United States Bankruptcy Judge
Western District of Missouri

Hon. Maureen A. Tighe
United States Bankruptcy Judge
Central District of California

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The Upcoming SCOTUS Decision in the *Appling* Case

Hon. Mary Grace Diehl
United States Bankruptcy Judge
Northern District of Georgia

IN RE: R. Scott APPLING, Debtor.

R. Scott Appling, Plaintiff–Appellant,

v.

Lamar, Archer & Cofrin, LLP, Defendant–Appellee.

No. 16-11911

United States Court of Appeals, Eleventh Circuit.

(February 15, 2017)

Background: Law firm brought adversary proceeding to except debt from discharge on "false pretenses, false representation, or actual fraud" theory. The United States Bankruptcy Court for the Middle District of Georgia, No. 3:13-bkc-03042-JPS, James P. Smith, Chief Judge, 527 B.R. 545, entered judgment in favor of firm, and debtor appealed. The District Court, No. 3:15-cv-00031-CAR, C. Ashley Royal, J., 2016 WL 1183128, affirmed. Debtor appealed.

Holdings: The Court of Appeals, William Pryor, Circuit Judge, held that:

(1) term "respecting," as used in dischargeability exception for debts obtained by materially false statements in writing "respecting the debtor's or an insider's financial condition," had to be given its ordinary meaning as referring to statements having a direct relation to, or impact on, the debtor's or an insider's financial condition;

(2) "statement respecting the debtor's or an insider's financial condition," as used in dischargeability exception, could not be interpreted narrowly as simply another way to refer to financial statement; and

(3) false statements that debtor allegedly made to members of law firm regarding an anticipated federal income tax refund, in order to convince firm to continue with legal representation despite mounting unpaid legal bills, were statements "respecting the debtor's financial condition," which, not being in writing, did not provide basis to except debt from discharge.

Reversed and remanded.

Rosenbaum, Circuit Judge, filed concurring opinion.

1. Bankruptcy ⚷3782

On appeal from district court's decision in its bankruptcy appellate capacity, the Court of Appeals assesses bankruptcy court's judgment anew, employing same standard of review that the district court itself used.

2. Bankruptcy ⚷3782, 3786

Bankruptcy court's factual findings are reviewed for clear error; its legal conclusions, de novo. Fed. R. Bankr. P. 8013.

3. Bankruptcy ⚷3372.7

Debt incurred by a fraudulent statement respecting the debtor's financial condition can be discharged in bankruptcy, if statement is oral and not in writing. 11 U.S.C.A. § 523(a)(2)(B).

4. Bankruptcy ⚷3372.7, 3372.8

If debtor's statements regarding an anticipated federal income tax return, statements which debtor made in order to persuade law firm to continue representing him in nonbankruptcy matter, were not statements "respecting his financial condition," then debtor could discharge his resulting debt to firm only if he disproved an element of fraud under the "false pretenses, false representation, or actual fraud" dischargeability exception; however, if statements were statements "respecting his financial condition," then debtor could discharge the debt without disproving any element of fraud because statements were

not in writing. 11 U.S.C.A. § 523(a)(2)(A, B).

5. Bankruptcy ⚷2021.1

Interpretation of the Bankruptcy Code starts where all such inquiries must begin, with language of the Code itself. 11 U.S.C.A. § 101 et seq.

6. Statutes ⚷1123

When statutory terms are left undefined, courts look to their ordinary, everyday meanings, unless the context indicates that they bear a technical sense.

7. Statutes ⚷1375

Statutory word or phrase is presumed to bear the same meaning throughout statutory text.

8. Bankruptcy ⚷3372.6

Term "respecting," as used in dischargeability exception for debts obtained by materially false statements in writing "respecting the debtor's or an insider's financial condition," had to be given its ordinary meaning as referring to statements having a direct relation to, or impact on, the debtor's or an insider's financial condition, something which a materially false statement regarding a single asset could have. 11 U.S.C.A. § 523(a)(2)(B).

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

9. Statutes ⚷1079

Judges have a responsibility to interpret the whole of statutory text.

10. Bankruptcy ⚷3372.6

"Statement respecting the debtor's or an insider's financial condition," as used in dischargeability exception, could not be interpreted narrowly as simply another way to refer to financial statement; term "financial statement" was technical term, which Congress would have used if that was what it meant. 11 U.S.C.A. § 523(a)(2)(B).

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

11. Statutes ⚷1151, 1156

When interpreting statute, court should, if possible, give effect to every word and every provision, and none should be needlessly given an interpretation that causes it to duplicate another provision or to have no consequence.

12. Bankruptcy ⚷3372.6

Term "statement," as used in dischargeability exception for debts obtained by materially false statements in writing respecting the debtor's or an insider's financial condition, meant any expression or embodiment in words, as opposed to a nonactionable omission. 11 U.S.C.A. § 523(a)(2)(B).

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

13. Statutes ⚷1108

When language of statute is clear, court need not look any further in interpreting it.

14. Bankruptcy ⚷3372.7

False statements that debtor allegedly made to members of law firm regarding an anticipated federal income tax refund, in order to convince firm to continue with legal representation despite mounting unpaid legal bills, were statements "respecting the debtor's financial condition," which, not being in writing, did not provide basis to except any resulting debt from discharge, even if they were knowingly made by debtor with intent to deceive firm, and if firm justifiably, or even reasonably, relied thereon. 11 U.S.C.A. § 523(a)(2)(B).

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

Appeal from the United States District Court for the Middle District of Georgia, D.C. Docket Nos. 3:15–cv–00031–CAR, 3:13–bkc–03042–JPS

Paul Whitfield Hughes, Michael B. Kimberly, Jonathan Weinberg, Mayer Brown, LLP, Washington, DC, Daniel L. Wilder, Law Offices of Emmett L. Goodman, Jr. LLC, Macon, GA, for Plaintiff–Appellant.

David William Davenport, Robert C. Lamar, Lamar Archer & Cofrin, Atlanta, GA, for Defendant–Appellee.

Before WILLIAM PRYOR and ROSENBAUM, Circuit Judges, and MARTINEZ,* District Judge.

WILLIAM PRYOR, Circuit Judge:

This appeal presents a question that has divided the federal courts: Can a statement about a single asset be a "statement respecting the debtor's . . . financial condition"? 11 U.S.C. § 523(a)(2). Ordinarily, a debtor cannot discharge any debt incurred by fraud, *id.* § 523(a)(2)(A), but a debtor can discharge a debt incurred by a false statement respecting his financial condition unless that statement is in writing, *id.* § 523(a)(2)(B). R. Scott Appling made false oral statements to his lawyers, Lamar, Archer & Cofrin, LLP, that he expected a large tax refund that he would use to pay his debt to the firm. After Lamar obtained a judgment against Appling for the debt, Appling filed for bankruptcy and Lamar initiated an adversary proceeding to have the debt ruled nondischargeable. The bankruptcy court and the district court ruled that Appling's debt could not be discharged under section 523(a)(2)(A) because it was incurred by fraud. But we disagree. Because Appling's statements about his tax refund "respect[ ] [his] . . . financial condition," *id.* § 523(a)(2)(B)(ii), and were not in writing, *id.* § 523(a)(2)(B), his debt to Lamar can be discharged in bankruptcy. We reverse and remand.

I. BACKGROUND

R. Scott Appling hired the law firm Lamar, Archer & Cofrin, LLP, to represent him in litigation against the former owners of his new business. Appling agreed to pay Lamar on an hourly basis with invoices for fees and costs due monthly. Appling became unable to keep current on the mounting legal bill and as of March 2005, owed Lamar $60,819.97. Lamar threatened to terminate the firm's representation and place an attorney's lien on all work product unless Appling paid the outstanding fees.

Appling and his attorneys held a meeting in March 2005. The bankruptcy court found that during this meeting Appling stated he was expecting a tax refund of "approximately $100,000," which would be enough to pay current and future fees. Lamar contends that in reliance on this statement, it continued its representation and did not begin collection of its overdue fees.

When Appling and his wife submitted their tax return, they requested a refund of only $60,718 and received a refund of $59,851 in October. The Applings spent this money on their business. They did not pay Lamar.

Appling and his attorneys met again in November 2005. The bankruptcy court found that Appling stated he had not yet received the refund. Lamar contends that in reliance on this statement, it agreed to complete the pending litigation and forego immediate collection of its fees but refused

* Honorable Jose E. Martinez, United States District Judge for the Southern District of Florida, sitting by designation.

to undertake any additional representation. In March 2006, Lamar sent Appling his final invoice for a principal amount due of $55,303.66 and $6,185.32 in interest.

Five years later, Lamar filed suit against Appling in a superior court in Georgia. In October 2012, Lamar obtained a judgment for $104,179.60. Three months later, the Applings filed for bankruptcy.

Lamar initiated an adversary proceeding against Appling in bankruptcy court. The bankruptcy court ruled that because Appling made fraudulent statements on which Lamar justifiably relied, Appling's debt to Lamar was nondischargeable, 11 U.S.C. § 523(a)(2)(A). The district court affirmed. The district court rejected Appling's argument that his oral statements "respect[ed] . . . [his] financial condition," 11 U.S.C. § 523(a)(2)(B), and should have been dischargeable. The district court ruled that "statements respecting the debtor's financial condition involve the debtor's net worth, overall financial health, or equation of assets and liabilities. A statement pertaining to a single asset is not a statement of financial condition." The district court agreed with the bankruptcy court that Appling made material false statements with the intent to deceive on which Lamar justifiably relied.

II. STANDARD OF REVIEW

[1, 2] When we sit as the second appellate court to review a bankruptcy case, *In re Glados, Inc.*, 83 F.3d 1360, 1362 (11th Cir. 1996), we "assess the bankruptcy court's judgment anew, employing the same standard of review the district court itself used," *In re Globe Mfg. Corp.*, 567 F.3d 1291, 1296 (11th Cir. 2009). "Thus, we review the bankruptcy court's factual findings for clear error, and its legal conclusions *de novo*." *Id.*

III. DISCUSSION

The Bankruptcy Code gives a debtor a fresh start by permitting him to discharge his pre-existing debts. But there are many exceptions to discharge. And some of those exceptions protect victims of fraud.

Section 523(a)(2) creates two mutually exclusive exceptions to discharge:

> **(a)** A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> . . .
>
> **(2)** for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
> **(A)** false pretenses, a false representation, or actual fraud, *other than a statement respecting the debtor's or an insider's financial condition*;
>
> **(B)** use of a *statement in writing*—
>
> (i) that is materially false;
>
> (ii) *respecting the debtor's or an insider's financial condition*;
>
> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
>
> (iv) that the debtor caused to be made or published with intent to deceive; . . .

11 U.S.C. § 523(a)(2) (emphasis added).

[3] The Code treats debts incurred by a statement "respecting the debtor's . . . financial condition" differently from other debts. *Id.* All fraud "other than a statement respecting the debtor's . . . financial condition" is covered by subsection (A). *Id.* § 523(a)(2)(A). Under subsection (A), a debtor cannot discharge a debt obtained by any type of fraudulent statement, oral or written. *Id.* A creditor also need prove

only justifiable reliance. *Field v. Mans*, 516 U.S. 59, 61, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995). But if a statement is made "respecting the debtor's ... financial condition," then subsection (B) governs. 11 U.S.C. § 523(a)(2)(B)(ii). To avoid discharge of a debt induced by a statement respecting the debtor's financial condition, a creditor must show reasonable reliance and that the statement was intentional, materially false, and in writing. *Id.* § 523(a)(2)(B). Thus, a debt incurred by an oral, fraudulent statement respecting the debtor's financial condition can be discharged in bankruptcy.

[4] We must determine whether Appling's statements about a single asset are "statement[s] respecting [his] ... financial condition." *Id.* § 523(a)(2). The bankruptcy court found that Appling made false oral statements about his anticipated tax refund to receive an extension of credit from Lamar. If these statements *do not* respect his financial condition, Appling can discharge his debt to Lamar in bankruptcy only if he disproves an element of fraud. *Id.* § 523(a)(2)(A). But if the statements *do* respect his financial condition, Appling can discharge his debt to Lamar because the statements were not in writing. *Id.* § 523(a)(2)(B).

The circuits and other federal courts are split on this question. The Fourth Circuit has held that a "debtor's assertion that he owns certain property free and clear of other liens is a statement respecting his financial condition." *Engler v. Van Steinburg*, 744 F.2d 1060, 1061 (4th Cir. 1984). Several bankruptcy courts—including one in this Circuit, *In re Aman*, 492 B.R. 550, 565 & n.47 (Bankr. M.D. Fla. 2010)—have agreed. *See, e.g., In re Carless*, No. 10–42988, slip op. at *3–4, 2012 WL 32700 (Bankr. D.N.J. Jan. 6, 2012); *In re Nicolai*, No. 05–29876, slip op. at *1, 2007 WL 405851 (Bankr. D.N.J. Jan. 31, 2007); *In re Hambley*, 329 B.R. 382, 399 (Bankr. E.D.N.Y. 2005); *In re Priestley*, 201 B.R. 875, 882 (Bankr. D. Del. 1996); *In re Kolbfleisch*, 97 B.R. 351, 353 (Bankr. N.D. Ohio 1989); *Matter of Richey*, 103 B.R. 25, 29 (Bankr. D. Conn. 1989); *In re Rhodes*, 93 B.R. 622, 624 (Bankr. S.D. Ill. 1988); *In re Howard*, 73 B.R. 694, 702 (Bankr. N.D. Ind. 1987); *In re Panaia*, 61 B.R. 959, 960–61 (Bankr. D. Mass. 1986); *In re Roeder*, 61 B.R. 179, 181 n.1 (Bankr. W.D. Ky. 1986); *In re Prestridge*, 45 B.R. 681, 683 (Bankr. W.D. Tenn. 1985). But the Fifth, Eighth, and Tenth Circuits have held that a statement about a single asset does not respect a debtor's financial condition because it "says nothing about the overall financial condition of the person making the representation or the ability to repay debt." *In re Bandi*, 683 F.3d 671, 676 (5th Cir. 2012); *see also In re Lauer*, 371 F.3d 406, 413–14 (8th Cir. 2004); *In re Joelson*, 427 F.3d 700, 706 (10th Cir. 2005). And some bankruptcy courts in other circuits have agreed. *See, e.g., In re Feldman*, 500 B.R. 431, 437 (Bankr. E.D. Penn. 2013); *In re Banayan*, 468 B.R. 542, 575–76 (Bankr. N.D.N.Y. 2012); *In re Campbell*, 448 B.R. 876, 886 (Bankr. W.D. Penn. 2011).

[5, 6] "[I]nterpretation of the Bankruptcy Code starts 'where all such inquiries must begin: with the language of the statute itself.'" *Ransom v. FIA Card Servs. N.A.*, 562 U.S. 61, 69, 131 S.Ct. 716, 178 L.Ed.2d 603 (2011) (quoting *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989)). Because the Code does not define the relevant terms, we look to "their ordinary, everyday meanings—unless the context indicates that they bear a technical sense." Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 69 (2012); *see also In re Piazza*, 719 F.3d 1253, 1261 (11th Cir. 2013) (applying this canon to the Bankruptcy Code). The

text and context establish that a statement about a single asset can be a "statement respecting the debtor's ... financial condition." 11 U.S.C. § 523(a)(2).

[7] "Financial condition" likely means one's overall financial status. Elsewhere in the statute, the Bankruptcy Code defines "insolvent" as the "financial condition such that the sum of such entity's debts is greater than all of such entity's property." *Id.* § 101(32)(A). In this context, the statute uses "financial condition" to describe the overall state of being insolvent, not any particular asset on its own. Because "[a] word or phrase is presumed to bear the same meaning throughout a text," Scalia & Garner, *supra*, at 170, we should interpret "financial condition" in section 523(a)(2) in the same way. Whether by its ordinary meaning or as a term of art, "financial condition" likely refers to the sum of all assets and liabilities.

But even if "financial condition" means the sum of all assets and liabilities, it does not follow that the phrase "statement *respecting* the debtor's ... financial condition," *Id.* § 523(a)(2) (emphasis added), covers only statements that encompass the entirety of a debtor's financial condition at once. Read in context, the phrase "statement *respecting* the debtor's ... financial condition," *id.* includes a statement about a single asset. We must not read the word "respecting" out of the statute. *See* Scalia & Garner, *supra*, at 174 ("If possible, every word ... is to be given effect.").

[8] "Respecting" is defined broadly as "[w]ith regard or relation to; regarding; concerning." *Respecting*, *Webster's New International Dictionary* 2123 (2d ed. 1961); *see also Respecting*, *Oxford English Dictionary* (online ed.) ("With respect to; with reference to; as regards."). For example, documents can "relate to" or "concern" someone's health without describing their entire medical history. Articles can "reference" the Constitution without quoting its entire text. Likewise, a statement can "respect" a debtor's "financial condition" without describing the overall financial situation of the debtor. The Supreme Court has interpreted "with respect to" in a statute to mean "direct relation to, or impact on." *Presley v. Etowah Cty. Comm'n*, 502 U.S. 491, 506, 112 S.Ct. 820, 117 L.Ed.2d 51 (1992). And the Court has interpreted "respecting" in the First Amendment to include any partial step toward the establishment of religion. *Lemon v. Kurtzman*, 403 U.S. 602, 612, 91 S.Ct. 2105, 29 L.Ed.2d 745 (1971). A statement about a single asset "relates to" or "impacts" a debtor's overall financial condition. And knowledge of one asset or liability is a partial step toward knowing whether the debtor is solvent or insolvent.

If the statute applied only to statements that expressed a debtor's overall financial condition, Congress could have said so. Lamar argues that "the preposition 'respecting' has no magic, expansive effect in the statute, it is simply a required grammatical device necessary to connect two related terms." Perhaps this argument would have more sway if the statute said "statement *of* the debtor's financial condition." But Congress did not use this language. Congress also did not say "statement indicating" or "revealing" or "disclosing" or "encompassing" the debtor's financial condition, phrases that would connote a full or complete expression of financial condition.

[9] Lamar dismisses the focus on the word "respecting" as "nothing more than a game of semantics," but judges have a responsibility to interpret the whole text. And "[s]ometimes the canon [of ordinary meaning] governs the interpretation of so simple a word as a preposition." Scalia & Garner, *supra*, at 71. A statement about a

single asset is still a statement *respecting* a debtor's financial condition.

[10] Lamar argues that because the legislative history often used "financial statement" in place of "statement respecting the debtor's . . . financial condition," 11 U.S.C. § 523(a)(2), we should read the statute to apply only to financial statements, but the word "statement" should also be given its ordinary meaning. Mere proximity of "statement" to "financial condition" is not enough to limit the meaning of the text. "Statement" is defined as "[t]hat which is stated; an embodiment in words of facts or opinions; a narrative; recital; report; account." *Statement*, *Webster's New International Dictionary* 2461 (2d ed. 1961). The definition of financial statement is technical and would exclude a statement about a single asset: "A balance sheet, income statement, or annual report that summarizes an individual's or organization's financial condition on a specified date or for a specified period by reporting assets and liabilities." *Financial Statement*, *Black's Law Dictionary* (10th ed. 2014). Setting aside the problems with legislative history, Lamar's argument works against it. Precisely because "[t]he term 'financial statement' has a strict, established meaning," *Joelson*, 427 F.3d at 709, we should expect the statute to say "financial statement" if it conveys that meaning. But the statute instead says "statement." To limit the definition to only "financial statements," Congress need only say so. *Cf.* 11 U.S.C. § 1125 (using the term "disclosure statement"); *Id.* § 101(49)(A)(xii) ("registration statement").

[11] The surplusage cannon supports our determination that "statement" should be given its ordinary meaning. "If possible, every word and every provision is to be given effect.... None should needlessly be given an interpretation that causes it to duplicate another provision or to have no consequence." Scalia & Garner, *supra*, at 174; *see also Reiter v. Sonotone Corp.*, 442 U.S. 330, 339, 99 S.Ct. 2326, 60 L.Ed.2d 931 (1979). In subsection (B), the statute says "use of a statement in writing." 11 U.S.C. § 523(a)(2)(B). Because a formal financial statement is almost always a written document (it is hard to imagine an oral recitation of all assets and liabilities), reading the statute to cover only financial statements would render the writing requirement surplusage.

[12] And in the context of a statute about fraud, the ordinary meaning of the word "statement" makes sense. Section 523(a)(2) creates two similar exceptions to discharge for debts incurred by fraud. Subsection (A) references specific common-law torts. *See Field*, 516 U.S. at 69, 116 S.Ct. 437 (" '[F]alse pretenses, a false representation, or actual fraud,' carry the acquired meaning of terms of art.... [T]hey imply elements that the common law has defined them to include." (quoting 11 U.S.C. § 523(a)(2)(A))). Subsection (B) enumerates its own elements which are analogous, but not identical to the common law elements. For example, where the common law requires justifiable reliance, section 523(a)(2)(B)(iii) requires reasonable reliance. *Field*, 516 U.S. at 72–75, 116 S.Ct. 437. Similarly, where the common law requires either an affirmative representation or an intentional omission, section 523(a)(2)(B) requires a "statement," as opposed to an omission. True, if Congress wanted to exclude omissions from subsection (B), it could have used the term "representation" and avoided the confusion with the term "financial statement." But Congress would not have said "false representation" without implying the common law term of art. *See Field*, 516 U.S. at 69, 116 S.Ct. 437. Accordingly, "statement" means an expression or embodiment in

words, as opposed to a nonactionable omission.

Lamar also argues that the "only way to give Section 523(a)(2)(A) meaning is to interpret it to provide a distinction between oral and written representations," but this argument reveals a fundamental misunderstanding of the statute. Section 523(a)(2)(A) covers most fraud. But section 523(a)(2)(B) covers statements respecting financial conditions. Lamar states that "certain oral misrepresentations must be non-dischargeable." They are. Any debt incurred by an oral misrepresentation that is not "respecting the debtor's financial condition" is nondischargeable under subsection (A). Appling provides a list of examples, including false representations about job qualifications and lies about the purpose and recipient of a payment. The question is how broadly to define the phrase "statement respecting the debtor's . . . financial condition," not whether allowing discharge of debts incurred by oral misrepresentations about finances is a good idea. The statute allows the discharge of debts incurred by oral statements so long as they "respect" the debtor's "financial condition." Lamar's argument is based on policy, not statutory structure.

[13] When the language of the statute is clear, we need not look any further. *See Puerto Rico v. Franklin Cal. Tax–Free Tr.*, ––– U.S. ––––, 136 S.Ct. 1938, 1946, 195 L.Ed.2d 298 (2016) (When "the statute's language is plain," "that is also where the inquiry should end." (internal quotations omitted)); *United States v. Great Northern Ry. Co.*, 287 U.S. 144, 154, 53 S.Ct. 28, 77 L.Ed. 223 (1932) ("[W]e have not traveled, in our search for the meaning of the lawmakers, beyond the borders of the statute."). A distaste for dishonest debtors does not empower judges to disregard the text of the statute. Because the text is not ambiguous, we hold that "statement[s] respecting the debtor's . . . financial condition" may include a statement about a single asset.

This result is also perfectly sensible. The requirement that some statements be made in writing promotes accuracy and predictability in bankruptcy disputes that often take place years after the facts arose. Lamar refers to our interpretation as a "giant fraud loophole." But the requirement of a writing is not at all unusual in the history of the law. From the Statute of Frauds to the Uniform Commercial Code, law sometimes requires that proof be in writing as a prerequisite to a claim for relief. This requirement may seem harsh after the fact, especially in the case of fraud, but it gives creditors an incentive to create writings before the fact, which provide the court with reliable evidence upon which to make a decision. In the context of a debt incurred by fraud, a lender concerned about protecting its rights in bankruptcy can easily require a written statement from the debtor before extending credit. Lamar, a law firm, could have required Appling to put his promise to spend his tax return on their legal fees in writing before continuing to represent him.

[14] This rule strikes a reasonable balance between the " 'conflicting interests' of discouraging fraud and of providing the honest but unfortunate debtor a fresh start." *In re Vann*, 67 F.3d 277, 284 (11th Cir. 1995) (quoting *Grogan v. Garner*, 498 U.S. 279, 287, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991)). The code does not unfairly reward dishonest debtors, but instead imposes different requirements of proof for different kinds of statements. A statement respecting a debtor's financial condition must be in writing, which helps both the honest debtor prove his honesty and the innocent creditor prove a debtor's dishonesty. And providing an incentive for credi-

tors to receive statements in writing may reduce the incidence of fraud. Because a statement about a single asset can be a "statement respecting the debtor's . . . financial condition," and because Appling's statements were not in writing, his debt can be discharged under section 523(a)(2)(B).

IV. CONCLUSION

We **REVERSE** the order ruling that Appling's debt to Lamar is nondischargeable and **REMAND** for further proceedings consistent with this opinion.

ROSENBAUM, Circuit Judge, concurring:

Sometimes things are not as they seem. Today we conclude that the phrase "statement respecting . . . the debtor's financial condition" in 11 U.S.C. § 523(a)(2) warrants a broad reading. As a result, Appling, the debtor in this case, will receive a discharge of the debt he incurred by lying about how he would pay for the legal services he dishonestly obtained. That certainly seems to frustrate a "primary purpose" of the Bankruptcy Act to provide relief to only the "honest debtor." *See Local Loan Co. v. Hunt*, 292 U.S. 234, 244, 54 S.Ct. 695, 78 L.Ed. 1230 (1934) (citation and internal quotation marks omitted).

But in actuality, the broad reading we give to the phrase "statement respecting . . . the debtor's financial condition" better promotes congressional intent to give a fresh start to only the "honest debtor" than does a narrow construction of the same phrase. This is so because the very same phrase appears in both §§ 523(a)(2)(A) and (B), and it must have the same meaning in both subsections. Though a narrow construction of the phrase in subsection (A) seems to further congressional intent to protect only the "honest debtor," a broad interpretation of the phrase in subsection (B) better comports with congressional intent. And the reality is that a broad construction of the phrase "statement respecting . . . the debtor's financial condition" in subsection (B) advances congressional intent to provide relief for only the "honest debtor" more than a narrow interpretation of the same phrase in subsection (A).

Because the words of the phrase alone are ambiguous, we must construe the phrase with an eye towards congressional intent in enacting the Bankruptcy Act. When we do that, it is clear that "statement respecting . . . the debtor's financial condition" must have the broad meaning that the panel attributes to it.

I.

There's no getting around it. Standing alone, the words of the phrase "statement respecting . . . the debtor's financial condition" are not unambiguous. True, the panel seems to think they are and argues that the words clearly mean any statement about any finance, asset, or liability that the debtor may have. But other courts have concluded that the language "statement respecting . . . the debtor's financial condition" refers to only statements about a debtor's overall financial circumstances—which do not include statements about only a single asset or liability.

Among the courts that appear to have understood the phrase to mean the opposite of what we conclude today is the Supreme Court, though the Supreme Court has not expressly addressed the meaning of the language. In *Field v. Mans*, 516 U.S. 59, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995), the Court held that a creditor need show only justifiable reliance on a fraudulent misrepresentation in order to except the debt incurred as a result of that reliance, from discharge under § 523(a)(2)(A).

In reaching this conclusion, the Supreme Court discussed § 523(a)(2)(A) and (B)'s references to "a statement respecting the debtor's ... financial condition" and conveyed its understanding that the words "financial condition" in § 523(a)(2) are a prohibition on excepting from discharge under both subsections (A) and (B) "debts traceable to ... a materially false *financial statement*," *id.* at 64, 116 S.Ct. 437 (emphasis added), apparently meaning "financial statement" as a term of art referring to a statement of net worth, not a statement about a single asset or liability. So at least at the time it decided *Field*, the Supreme Court appeared to have a different understanding of the phrase "a statement respecting the debtor's ... financial condition" than we embrace today.

To be sure, I do not suggest that *Field*'s discussion of the meaning of "a statement respecting the debtor's ... financial condition" purports to instruct courts on the proper meaning of § 523(a)(2)(A). But the Supreme Court's understanding as conveyed in *Field* demonstrates that the language of the phrase is fairly susceptible of more than one meaning.

Three other circuits have likewise concluded that the phrase "a statement respecting the debtor's ... financial condition" must be construed narrowly, to refer to only those statements about a debtor's overall net worth—though they do not appear to have determined the language of the phrase to have an unambiguous meaning. *See*, *e.g.*, *In re Bandi*, 683 F.3d 671 (5th Cir. 2012); *In re Lauer*, 371 F.3d 406 (8th Cir. 2004); *In re Joelson*, 427 F.3d 700 (10th Cir. 2005).

But while the language itself of the phrase in question may not be unambiguous, that doesn't mean that § 523(a)(2) is ambiguous in the overall statutory scheme. When we construe a statute, we must do so not only by looking to the language itself, but also by reference to "the specific context in which that language is used, and the broader context of the statute as a whole." *Yates v. United States*, ––– S.Ct. ––––, 135 S.Ct. 1074, 1081–82, 191 L.Ed.2d 64 (2015) (citation and quotation marks omitted). And when we do that, it is clear that we must give the phrase "a statement respecting the debtor's ... financial condition" a broad construction.

The Supreme Court has repeatedly emphasized that the Bankruptcy Code "limits the opportunity for a completely unencumbered new beginning to the 'honest but unfortunate debtor.'" *Grogan v. Garner*, 498 U.S. 279, 287, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991) (quoting *Hunt*, 292 U.S. at 244, 54 S.Ct. 695). For this reason, only honest debtors receive the benefit of the general policy that exceptions to discharge are to be construed strictly against the creditor and liberally in favor of the debtor. *In re St. Laurent*, 991 F.2d 672, 680 (11th Cir. 1993). Indeed, we have said that "the malefic debtor may not hoist the Bankruptcy Code as protection from the full consequences of fraudulent conduct." *Id.* at 680–81.

So to the extent that the language "statement respecting ... the debtor's financial condition" is fairly and reasonably susceptible of a construction that better furthers congressional intent to protect only the honest debtor, we are obliged to apply that interpretation. When it comes to § 523(a)(2), a broad construction is reasonable and better accomplishes this purpose than a narrow one.

As the panel notes, the phrase "statement respecting ... the debtor's financial condition" appears in both subsections (A) and (B). We therefore presume it to have the same meaning in both subsections. *See Mohasco Corp. v. Silver*, 447 U.S. 807, 826, 100 S.Ct. 2486, 65 L.Ed.2d 532 (1980) ("[W]e cannot accept respondent's position

without unreasonably giving the word 'filed' two different meanings in the same section of the statute.").

But though the words have the same meaning in both subsections (A) and (B), they have opposite effects on whether a debtor may discharge a debt for something obtained through the use of a "statement respecting ... the debtor's financial condition." Under subsection (A), which refers to oral statements, if a statement falls within the meaning of "statement respecting ... the debtor's financial condition," the debt incurred as a result of that statement is dischargeable. Meanwhile, under subsection (B), which refers to written statements, if a statement comes within the meaning of "statement respecting ... the debtor's financial condition," the debt incurred as a result of that statement is not dischargeable, provided that the other conditions in subsection (B) are satisfied.

So if the phrase has a broad meaning, more false oral statements will have the effect of exempting a debt incurred as the result of a misrepresentation, from the exception to discharge (meaning that such debts will be discharged), than if we construe the phrase narrowly. But fewer false written statements will result in excusing a debt for a fraudulently obtained asset, service, or loan. And since it seems likely that, at least in arm's length transactions, most significant debts are obtained as the result of written representations about finances, as opposed to oral ones, a broader interpretation of the phrase is less likely to benefit dishonest debtors than a narrow construction of it.

II.

For these reasons, I agree with the panel that we must construe the phrase "statement respecting ... the debtor's financial condition" broadly. To be sure, doing so has the effect of allowing Appling's debt for legal services, which the bankruptcy court concluded he obtained by lying to Lamar about the tax refund, to be discharged. But in the overall statutory scheme, the broad interpretation better promotes Congress's concern to provide relief to "honest debtors" only.

IN RE: Jon E. LUNSFORD, Sr., Debtor.

Jon E. Lunsford, Sr., Plaintiff-Appellant,

v.

Process Technologies Services, LLC, Defendant-Appellee.

No. 16-11578

United States Court of Appeals, Eleventh Circuit.

(February 15, 2017)

Background: Investor in debtor's limited liability company (LLC) brought adversary proceeding to except debt from discharge. The United States Bankruptcy Court for the Northern District of Georgia, No. 12-bkc-80136-CRM, entered judgment in favor of investor, and debtor appealed. The District Court, No. 1:15-cv-02323-SCJ, affirmed. Debtor appealed.

Holdings: The Court of Appeals, William Pryor, Circuit Judge, held that:

(1) dischargeability exception for debts "for the violation of" federal securities laws or any state securities law was not limited in its application only to debts arising from debtor's own viola-

fense the petitioner committed qualifies as an aggravated felony, the government has not met its burden of proving that the defendant committed an aggravated felony.").

CONCLUSION

Notash's conviction under § 542 is not an offense involving moral turpitude because the record does not disclose under which paragraph he was convicted, and a conviction can be obtained under the second paragraph without proof of evil intent or intent to defraud. His conviction therefore does not categorically qualify as a crime involving moral turpitude. Further, the government has failed to meet its burden under the modified categorical approach.

PETITION FOR REVIEW GRANTED.

In re Jeanne Lavonne JOELSON, Debtor.

Stanley Cadwell, Plaintiff–Appellee,

v.

Jeanne Lavonne Joelson, Defendant–Appellant.

No. 04–8052.

United States Court of Appeals, Tenth Circuit.

Oct. 24, 2005.*

Background: Judgment creditor filed adversary complaint, seeking determination that debt arising from Chapter 7 debtor's fraudulent statements was excepted from discharge. The United States Bankruptcy Court for the District of Wyoming found the debt to be nondischargeable, and debtor appealed. The Bankruptcy Appellate Panel (BAP), Brown, J., 307 B.R. 689, affirmed. Debtor appealed.

Holdings: Addressing an issue of apparent first impression for the court, the Court of Appeals, Ebel, Circuit Judge, held that:

(1) phrase "respecting the debtor's financial condition," as used in the discharge exception for false pretenses, a false representation, or actual fraud, should be interpreted strictly to refer only to information on a debtor's overall financial net worth or condition;

(2) in the case at bar, debtor's representations concerning her ownership of specific assets did not qualify as statements "respecting the debtor's financial condition"; and

(3) debtor's statements concerning her intention and specific ability to obtain financing to repay the loan were not statements "respecting the debtor's financial condition."

Affirmed.

1. Bankruptcy ⚷3770, 3771

Court of Appeals could not disturb the bankruptcy court's factual findings where debtor-appellant had never contested the bankruptcy court's factual findings and debtor's appendix contained only the bankruptcy court's docket sheet, order, and

* After examining the briefs and appellate record, this panel has determined unanimously to grant the parties' request for a decision on the briefs without oral argument. *See* Fed. R.App. P. 34(f) and 10th Cir. R. 34.1(G). The case is therefore ordered submitted without oral argument.

judgment, and the Bankruptcy Appellate Panel's (BAP) docket sheet and opinion.

2. Bankruptcy ⚷3811

When reviewing Bankruptcy Appellate Panel (BAP) decisions, the Court of Appeals independently reviews the bankruptcy court decision.

3. Bankruptcy ⚷3782

Court of Appeals reviews the bankruptcy court's legal determinations de novo.

4. Bankruptcy ⚷3411

After an individual debtor files for Chapter 7 bankruptcy, court generally discharges all of the debtor's pre-existing obligations. 11 U.S.C.A. § 727.

5. Bankruptcy ⚷3372.1

Some debts incurred as a result of a Chapter 7 debtor's fraudulent actions or statements cannot be discharged in bankruptcy. 11 U.S.C.A. §§ 523(a)(2), 727.

6. Bankruptcy ⚷3372.6

If a debt is obtained by a false oral statement respecting the debtor's financial condition, the debt is dischargeable. 11 U.S.C.A. § 523(a)(2)(A).

7. Bankruptcy ⚷3372.28

Debt obtained by a false written statement respecting the debtor's financial condition is not dischargeable, provided certain conditions are met. 11 U.S.C.A. § 523(a)(2)(B).

8. Statutes ⚷209

Pursuant to a rule of statutory construction, identical words used in different parts of the same act are intended to have the same meaning.

9. Bankruptcy ⚷3372.6

Phrase "respecting the debtor's financial condition," as used in statutory exception to discharge for debt obtained by debtor's false pretenses, false representation, or actual fraud, other than a statement respecting debtor's or an insider's financial condition, should be interpreted strictly to refer only to information on a debtor's overall financial net worth or condition. 11 U.S.C.A. § 523(a)(2)(A).

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

10. Bankruptcy ⚷2021.1

When the meaning of the Bankruptcy Code is not clear from the statute's text, the court may examine the provision's legislative history.

11. Bankruptcy ⚷3372.6

Statements that present a picture of a debtor's overall financial health, and that therefore constitute statements "respecting the debtor's financial condition," within the meaning of the statutory exception to discharge for debts obtained by debtor's false pretenses, false representation, or actual fraud, other than a statement respecting debtor's or an insider's financial condition, include those analogous to balance sheets, income statements, statements of changes in overall financial position, or income and debt statements that present the debtor or insider's net worth, overall financial health, or equation of assets and liabilities. 11 U.S.C.A. § 523(a)(2)(A).

12. Bankruptcy ⚷3372.6

To constitute statements "respecting the debtor's financial health," for dischargeability purposes, statements need not carry the formality of a balance sheet, income statement, statement of changes in financial position, or income and debt statement; what is important is not the formality of the statement, but the information contained within it, that is, whether it is information as to the debtor's or insider's overall net worth or overall income flow. 11 U.S.C.A. § 523(a)(2)(A).

13. Bankruptcy ⚷3372.6

Chapter 7 debtor's representations to judgment creditor concerning her ownership of specific assets did not qualify as statements "respecting the debtor's financial condition," within the meaning of the statutory exception to discharge for debts obtained by debtor's false pretenses, false representation, or actual fraud, other than a statement respecting debtor's or an insider's financial condition, and so the judgment debt was not dischargeable; these representations did not concern debtor's overall financial health analogous to a balance sheet, income statement, statement of changes in financial position, or income and debt statement. 11 U.S.C.A. § 523(a)(2)(A).

14. Bankruptcy ⚷3372.6

Chapter 7 debtor's representations to judgment creditor concerning her intention and specific ability to obtain financing from her brother to repay the loan were not statements "respecting the debtor's financial condition," within the meaning of the statutory exception to discharge for debts obtained by debtor's false pretenses, false representation, or actual fraud, other than a statement respecting debtor's or an insider's financial condition, and so the judgment debt was not dischargeable; representations at issue were analogous to debtor's statement that she owned one particular asset, and just as a statement about one of debtor's assets was not a statement that reflected her overall financial health, and so was not one respecting her financial condition, statements about one part of debtor's income flow did not reflect her overall financial health. 11 U.S.C.A. § 523(a)(2)(A).

Ken McCartney, Cheyenne, WY, for Defendant–Appellant.

Lawrence E. Middaugh, Casper, WY, for Plaintiff–Appellee.

Before EBEL, O'BRIEN and TYMKOVICH, Circuit Judges.

EBEL, Circuit Judge.

This appeal requires us to determine whether a state court judgment against Defendant–Appellant Jeanne Joelson ("Debtor" or "Joelson") based on Joelson's nonpayment of a loan from Plaintiff–Appellee Stanley Cadwell ("Creditor" or "Cadwell") should not be discharged in Joelson's Chapter 7 bankruptcy because Joelson made fraudulent misrepresentations to Cadwell in order to obtain the loan. Relying on 11 U.S.C. § 523(a)(2)(A), the United States Bankruptcy Court for the District of Wyoming ("bankruptcy court") and the Bankruptcy Appellate Panel of the Tenth Circuit ("BAP") found that the state court judgment should not be discharged. In this appeal, Joelson argues that the BAP erred because the representations that she made to Cadwell were statements "respecting [her] financial condition" as defined by § 523(a)(2)(A), and debts incurred based on such statements are dischargeable under § 523(a)(2)(A) notwithstanding that provision's general prohibition on discharging debts obtained by "false pretenses, a false representation, or actual fraud." We affirm the judgment of the BAP.

BACKGROUND

I. The Underlying Events

[1] Joelson has never contested the bankruptcy court's factual findings. Moreover, Joelson's appendix contains only the bankruptcy court's docket sheet, order and judgment, and the BAP's docket sheet and opinion. Thus we may not disturb the bankruptcy court's factual findings in this

case, and we draw the following description of the events underlying this suit from those findings. *See Jenkins v. Hodes (In re Hodes),* 287 B.R. 561, 570 (D.Kan.2002) ("[B]ecause the parties do not specifically contest the bankruptcy court's findings of fact, the court will not disturb this ruling on appeal."), *aff'd,* 402 F.3d 1005 (10th Cir.2005); *cf. McEwen v. City of Norman,* 926 F.2d 1539, 1550 (10th Cir.1991) (noting that we are unable to review an appellant's factual contention when the evidentiary matters relied on by a lower court are not included in the record on appeal).

Cadwell is a single, retired man who lives in Casper, Wyoming. Cadwell met Joelson at a café in Casper where she was working as a waitress. Around March 1996, Joelson told Cadwell that she needed to travel to Scottsdale, Arizona to check on a house that she owned and pick up her mother.

Cadwell agreed to drive Joelson from Casper to Scottsdale. While Cadwell and Joelson were in Scottsdale, someone gave Joelson money. Joelson represented to Cadwell that the money was rent for the house that she owned in Scottsdale.

After Cadwell and Joelson returned to Casper, Joelson informed Cadwell that she needed a loan of over $50,000 to save her Scottsdale home from foreclosure. Joelson stated that her brother, Larry Oltman, would later loan her these funds, and that as soon as Oltman did so, she would repay Cadwell. Joelson promised that she would provide Cadwell with collateral to secure the loan and represented that she owned residences in both Casper and Glendo, Wyoming; a motel in Glendo; and a number of antique vehicles stored in Glendo. When Cadwell asked to see the properties, Joelson took Cadwell to Glendo and showed Cadwell the inside of a house, the outside of another house and a motel, and a storage facility in which the antique cars were allegedly housed. Joelson also provided Cadwell with a list of the antique cars that she allegedly owned.

After he viewed the properties, Cadwell mortgaged his home and borrowed over $50,000. Joelson gave Cadwell a promissory note,[1] and the two traveled to Arizona, where they met with a lender's representatives regarding the foreclosure. In the course of these dealings, Cadwell learned that the Arizona property was titled in the name of "Joelene M. Joelson." However, Cadwell knew Debtor as "Jeanne Joelson," not "Joelene M. Joelson." After Debtor told Cadwell that she and "Joelene M. Joelson" were the same person, Cadwell advanced approximately $54,000 to Joelson to pay off the Deed of Trust.

Cadwell's attempts to collect the loan have proved fruitless, as Joelson has not repaid the loan or forfeited collateral. Joelson has rebuffed Cadwell's claims by asserting that she never had an interest in the Scottsdale property and that the funds that Cadwell gave to her in connection with that property were a gift.

II. The Proceedings Below

Before bringing this suit, Cadwell brought suit in Wyoming state court on the promissory note that Joelson had given

1. The promissory note is not part of the record, and there is no indication in the opinions of the bankruptcy court or the BAP as to the note's contents. Thus, it is not clear whether all of the properties and the antique cars that Joelson said she owned were intended as collateral. However, we need not determine what Joelson listed as collateral in the note in order to resolve this appeal. This is because we only need consider the fact that Joelson made representations as to her ownership of various properties and vehicles in order to obtain a loan from Cadwell.

to him. The state court entered judgment ("the state court judgment") against Joelson. After Joelson filed for Chapter 7 bankruptcy, Cadwell filed an adversary proceeding in the bankruptcy court seeking to bar all of Joelson's debts—or, in the alternative, just the state court judgment—from being discharged.

Joelson failed to appear before the bankruptcy court. Nonetheless, Joelson's counsel presented Joelson's case to the court, and both parties presented closing arguments. The bankruptcy court refused to deny the discharge of all claims against Joelson, but the court relied on § 523(a)(2)(A) to hold that Cadwell's claim was not dischargeable.

In making this ruling, the bankruptcy court was unable to conclude whether Jolene Joelson, Joelene Joelson, and Jeanne Joelson are three names for Debtor, or two (or three) separate people. However, the court did determine that Joelson's assertion that she owned "residences in both Casper and Glendo, a motel in Glendo, and a number of antique vehicles stored in Glendo" was false.

On appeal, the BAP affirmed the bankruptcy court's decision. The BAP ruled that some of the misrepresentations that Joelson made to Cadwell were not statements "respecting [her] financial condition." As a result, the BAP ruled that under § 523(a)(2)(A) those misrepresentations, which induced Cadwell to loan money to Joelson, prevented the state court judgment from being discharged.

This appeal from Joelson followed.

DISCUSSION

I. Overview

[2, 3] We have jurisdiction over this appeal pursuant to 28 U.S.C. § 158. *See* 28 U.S.C. § 158(d). "When reviewing BAP decisions, we independently review the bankruptcy court decision." *In re Myers,* 362 F.3d 667, 670 (10th Cir.2004). We review the bankruptcy court's legal determinations *de novo. See Panalis v. Moore (In re Moore),* 357 F.3d 1125, 1127 (10th Cir.2004).

[4, 5] In general, after an individual debtor files for Chapter 7 bankruptcy, a court discharges all of the debtor's preexisting obligations. *See* 11 U.S.C. § 727. However, some debts incurred as a result of the debtor's fraudulent actions or statements cannot be discharged in bankruptcy. *See id.* § 523(a)(2). The Bankruptcy Code sets out the types of fraudulent actions or statements that render debts incurred as a result of those statements either non-dischargeable or dischargeable. *See id.*

[6, 7] Specifically, 11 U.S.C. § 523(a)(2)(A) states that a debt obtained by "false pretenses, a false representation, or actual fraud" is not dischargeable. However, § 523(a)(2)(A) contains an exception: If a debt is obtained by a false *oral* "statement respecting the debtor's ... financial condition," the debt *is* dischargeable. By contrast, 11 U.S.C. § 523(a)(2)(B) states that a debt obtained by a false *written* statement "respecting the debtor's ... financial condition" is *not* dischargeable, provided certain conditions are met.

[8] Because the phrase "respecting the debtor's ... financial condition" is used in both § 523(a)(2)(A) and § 523(a)(2)(B) and both provisions were enacted as part of the same statute, *see* Pub.L. No. 95–598, Nov. 6, 1978, 92 Stat. 2590, this is "a classic case for application of the normal rule of statutory construction that identical words used in different parts of the same act are intended to have the same meaning." *Sullivan v. Stroop,* 496 U.S. 478, 484, 110 S.Ct. 2499, 110 L.Ed.2d 438 (1990) (quotations omitted). However, because § 523(a)(2)(A) provides that a debt ob-

tained by a false oral statement "respecting the debtor's . . . financial condition" is dischargeable, and § 523(a)(2)(B) provides that a debt obtained by a false written version of such a statement is not dischargeable, any interpretation of the phrase "respecting the debtor's . . . financial condition" will have opposing effects depending on whether the statement was oral or written. If the phrase is broadly construed so that more false oral statements qualify as "respecting the debtor's . . . financial condition," more debts will be dischargeable under § 523(a)(2)(A) because that provision allows debts obtained by oral versions of such statements to be discharged—even though debts obtained by other false pretenses, false representations, or actual fraud may not be discharged. By contrast, a broad construction of the phrase "respecting the debtor's . . . financial condition," will result in fewer debts obtained based on written versions of such statements to be dischargeable under § 523(a)(2)(B) because that provision bars the discharge of only those false statements that "respect[ ] the debtor's . . . financial condition."

The opposing nature of § 523(a)(2)(A) and (B) is visible from the text of the statute, which provides:

> (a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt—
>
> . . . .
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
>
> (B) use of a statement in writing—
>
> (i) that is materially false;
>
> (ii) respecting the debtor's or an insider's financial condition;
>
> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
>
> (iv) that the debtor caused to be made or published with intent to deceive.

11 U.S.C. § 523(a)(2)(A)-(B).

The phrase "respecting the debtor's . . . financial condition" has a range of potential meanings. Under what many of the courts who have considered this issue refer to as the "broad interpretation," a statement "respecting the debtor's . . . financial condition" is any communication that has a bearing on the debtor's financial position. *Skull Valley Band of Goshute Indians v. Chivers (In re Chivers),* 275 B.R. 606, 614 (Bankr.D.Utah 2002). Thus, the broad interpretation posits that a communication addressing the status of a single asset or liability qualifies as "respecting the debtor's . . . financial condition." *See id.*

Under what courts refer to as the "strict interpretation," a statement "respecting the debtor's . . . financial condition" is any communication that presents an overall picture of the debtor's financial position. *Id.* at 615. This interpretation limits statements "respecting the debtor's . . . financial condition" to communications that purport to state the debtor's overall net worth, overall financial health, or equation of assets and liabilities. *See id.*

In this case, because most of the preloan communications between Joelson and Cadwell were oral, the parties focus on § 523(a)(2)(A), which addresses false oral communications.[2] Joelson argues that the

2. Because neither the parties nor the courts below address whether the list of antique vehicles that Joelson provided to Cadwell renders the state court judgment nondischarge-

phrase "respecting the debtor's ... financial condition" should be interpreted broadly to include all oral communications that reflect on the extent of any of her assets, liabilities, and income. Joelson takes this position because under § 523(a)(2)(A), although debts obtained by "false pretenses, a false representation, or actual fraud" are not dischargeable, debts obtained by false statements "respecting the debtor's ... financial condition" are dischargeable. Thus, it is in Joelson's interest for her communications to Cadwell to qualify as "respecting [her] financial condition," so that the state court judgment can be discharged. As is discussed below, Joelson's communications with Cadwell did contain some information as to her assets and income, so the state court judgment would be dischargeable under the broad interpretation she urges.

On the other hand, Cadwell argues that the phrase "respecting the debtor's ... financial condition" should be interpreted strictly to include only information as to Joelson's overall financial health, not information as to her individual assets or liabilities. As is discussed below, none of Joelson's communications with Cadwell contain information on Joelson's overall net worth, overall financial condition, or overall ability to generate income. Thus, if the phrase "respecting the debtor's ... financial condition" is interpreted strictly, the state court judgment would not be dischargeable under § 523(a)(2)(A) because Joelson would have obtained a loan by "false pretenses, a false representation, or actual fraud"—not a false statement "respecting [her] financial condition." This would prevent Cadwell from having to settle for his claim against Joelson being resolved at a discount in bankruptcy court.

Therefore, our legal interpretation of the scope of the phrase "respecting the debtor's ... financial condition" will determine the outcome of this case. For the reasons discussed below, we believe that the strict interpretation of the phrase is most consistent with the text and structure of the Bankruptcy Code, Congress's intent as expressed in the legislative history of 11 U.S.C. § 523(a)(2)(A) and (B), and case law.

II. Legal Analysis

A. Text, Structure and Policy of the Bankruptcy Code

[9] The Bankruptcy Code does not offer a definition of the phrase "respecting the debtor's ... financial condition." Nor does the Code even offer a definition of the term "financial condition." However, the Code's definition of the term "insolvent" provides tangential support for the proposition that the phrase "respecting the debtor's ... financial condition" should be construed as relating only to information on the debtor's overall financial condition.

The Code defines "insolvent" as, *inter alia*, the "*financial condition* such that the sum of [an] entity's debts is greater than all of such entity's property ... exclusive of [certain types] of property." 11 U.S.C. § 101(32)(A) (emphasis added); *see also id.* § 101(32)(C) (defining a municipality's insolvency as the "*financial condition* such that the municipality is (i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or (ii) unable to pay its debts as they become due") (emphasis added). The

able under § 523(a)(2)(B), we need not and do not consider the issue. *See Singleton v. Wulff*, 428 U.S. 106, 120, 96 S.Ct. 2868, 49 L.Ed.2d 826 (1976); *Bancamerica Commercial Corp. v. Mosher Steel of Kan., Inc.*, 100 F.3d 792, 798–99 (10th Cir.), *op. amended on other grounds*, 103 F.3d 80 (10th Cir.1996).

Code's use of the term "financial condition" in these definitions to refer to the difference between an entity's overall property and debts—the entity's net worth—in defining the word "insolvent" suggests that the term "financial condition" in § 523(a)(2)(A) and (B) also relates to a debtor's net worth or overall financial condition. This conclusion is buttressed by the fact that the Code uses the term "financial condition" to refer to an overall flow of funds—a cash flow—in defining when a municipality is insolvent.

Perhaps more importantly, as noted above, the text and structure of § 523(a)(2)(A) and (B) reveal that any interpretation of the phrase "respecting the debtor's ... financial condition" will have opposing impacts on debtors and creditors under each of the sections. A strict reading fits better within the overall structure of the statute. The statute treats oral and written statements "respecting the debtor's ... financial condition" very differently. If a debtor's oral statements "respecting [his or her] financial condition" later turn out to be false, debts obtained based on such statements can still be discharged under § 523(a)(2)(A). However, other fraudulent oral communications still bar from discharge debts obtained based on such communications under that provision, and under § 523(a)(2)(B) written statements "respecting the debtor's ... financial condition" bar debts obtained based on them from discharge.

In oral communication, it is far more difficult to portray accurately one's overall financial position than to represent the condition of one particular asset or liability. After all, such communication is often informal and spontaneous, and one might simply forget a particular asset or liability when listing all of one's assets and liabilities. However, when asked to describe a particular asset or liability, one has had a particular subject called specifically to mind. Therefore, it is logical to give more leeway (and more dischargeability) to a debtor who errs in stating his or her overall position orally, since it is more likely that he or she may have made a mistake inadvertently. It is also logical to give less leeway to a debtor who makes a specific oral misrepresentation as to a particular asset, because it is less likely that such a misrepresentation is inadvertent. By the same token, it is logical to give little leeway (and less dischargeability) under § 523(a)(2)(B) to a debtor who fraudulently misstates his or her overall financial position in writing, since such communications carry an air of formality that their oral counterparts do not and are typically made after more studied consideration.

Thus, a strict interpretation of the phrase "respecting the debtor's ... financial condition" to limit such representations to statements going to a debtor's overall financial net worth or financial condition is in keeping with the text and structure of § 523(a)(2)(A) and (B).

B. Legislative History of § 523(a)(2)(A) and (B)

[10] The legislative history of § 523(a)(2)(A) and (B) corroborates the view that the strict definition of "respecting the debtor's ... financial condition" is most in keeping with Congress's intent in promulgating these provisions.[3]

1. Roots of § 523(a)(2)(A) and (B)

Section 523(a)(2)(A) has its roots in the Bankruptcy Act of 1898, 30 Stat. 544.

3. We may examine this legislative history because this is not a case where the meaning of the Bankruptcy Code is clear from the statute's text. *Cf. United States v. Ron Pair Enters., Inc.,* 489 U.S. 235, 240–41, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989).

When the predecessor to § 523(a)(2)(A) was included in the Bankruptcy Code in 1898 and amended in 1903, it barred the discharge of debts arising from false pretenses or false representations. *See* Bankruptcy Act of 1898, 30 Stat. 544, 550–51, § 17(a)(2); Act of Feb. 5, 1903, ch. 487, 32 Stat. 797, 798, § 17(a)(2). In contrast to present-day § 523(a)(2)(A), neither the 1898 nor the 1903 provision allowed the discharge of debts obtained by false oral statements "respecting the debtor's ... financial condition." *See id.* This approach remained substantially unchanged until 1978, when the 1903 provision was reworded and recodified as § 523(a)(2)(A).

Congress inserted the predecessor of § 523(a)(2)(B) into the Bankruptcy Act of 1898 in 1903. *See* Act of Feb. 5, 1903, ch. 487, 32 Stat. 797, 797–98, § 4. The predecessor to § 523(a)(2)(B) was a separate provision that provided grounds for a court to deny the discharge of all of a debtor's obligations, not merely to deny the discharge of a particular debt obtained through the use of a materially false statement in writing. *See id.* at § 4(b)(3) ("The judge shall ... discharge the applicant unless he has ... obtained property on credit from any person upon a materially false statement in writing...."). Therefore, as of 1903, if a debtor had obtained property on credit through the use of an oral misrepresentation, that particular debt would be excepted from discharge; if a debtor had obtained property on credit through the use of a written misrepresentation, none of the debtor's debts could be discharged.

2. 1960 Amendments

By 1960 it had become clear to Congress that the predecessor to § 523(a)(2)(B) was having undesirable effects: imposing severe penalties on noncommercial bankrupts, opening the way to abuse by some creditors, and yielding windfalls for other creditors. *See* S.Rep. No. 1688, at 2–3 (1960), *reprinted in* 1960 U.S.C.C.A.N. 2954, 2955. Congress was particularly concerned with the abusive practices of certain commercial creditors who "frequently condoned, or even encouraged, [would-be debtors'] issuance of statements omitting debts with the deliberate intention of obtaining a false agreement for use in the event that the borrower subsequently goes into bankruptcy." *Id.* (quoting H.R.Rep. No. 1111, at 2–3 (1959)) (quotations in original omitted), *reprinted in* 1960 U.S.C.C.A.N. 2954, 2955. "[A]rmed with a false financial statement," these creditors had "a powerful weapon with which to intimidate a debtor into entering an agreement in which the creditor agree[d] not to oppose the discharge in return for the debtor's agreement to pay the debt in full after discharge." *Id.* (quotations in original omitted).

Based on these concerns, Congress recrafted the predecessor to § 523(a)(2)(B) so that false written financial statements made by individuals no longer barred the discharge of all of an individual debtor's obligations. *See* Act of July 12, 1960, Pub.L. No. 86–621, 74 Stat. 408, 409, § 2. Instead, the statutory language addressing such written statements was combined with the precursor of § 523(a)(2)(A) so that only the specific debt incurred as a result of the false written financial statement was not dischargeable. *See id.* Under the 1960 amendment the language of the newly-combined predecessor provision to § 523(a)(2)(A) and (B) did not explicitly allow the discharge of debts incurred based on oral misrepresentations going to financial condition. *See id.*

However, the legislative history's repeated references to false "financial statement[s]," S.Rep. No. 1688, at 2–3 (1960) (using the term "financial statement" sev-

en times) (quotations in original omitted), *reprinted in* 1960 U.S.C.C.A.N. 2954, 2955, lends support to a strict interpretation of that phrase restricting it to statements pertaining to the overall financial condition of the debtor—and, by extension, to a similarly strict interpretation of the similar phrase "respecting the debtor's . . . financial condition" in § 523(a)(2)(A) and (B). The term "financial statement" has a strict, established meaning, suggesting that the phrase "statement respecting [the bankrupt's] financial condition" for which it is so freely substituted should be given the same meaning. *See Black's Law Dictionary* (8th ed.2004) (defining "financial statement" as "[a] balance sheet, income statement, or annual report that summarizes an individual's or organization's financial condition on a specified date or for a specified period by reporting assets and liabilities" or an "income-and-expense declaration"). Moreover, the legislative history's reference to businesses' use of financial statements to establish credit standing also lends support to the strict interpretation of the phrase "statement respecting [the bankrupt's] financial condition," for it is communications as to a person's overall financial condition that are typically used to establish such standing. *See* S.Rep. No. 1688, at 2–3 (1960), *reprinted in* 1960 U.S.C.C.A.N. 2954, 2955.

3. 1978 Recodification

In 1978, Congress gave the provisions at issue in this case much of their current wording and recodified them as § 523(a)(2)(A) and (B). *See* Pub.L. No. 95–598, Nov. 6, 1978, 92 Stat. 2590. The House Committee on the Judiciary noted that the bill that formed the backbone of § 523(a)(2)(A) and (B) was "modified only slightly" from its predecessor, and none of the modifications noted by the Committee impact the meaning of "respecting the debtor's . . . financial condition." H. Rep. No. 95–595, at 364, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6320; *see also* S.Rep. No. 95–989, at 78, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5864. Indeed, Don Edwards, a member of the House Committee on the Judiciary, introduced the amendment that embodied the compromises worked out by the Conference Committee—the final amendment to the bill before its passage—by stating that § 523(a)(2)(A) "is intended to codify current case law." Statement by the Hon. Don Edwards, Sept. 28, 1978, 124 Cong. Rec. H. 11089, *reprinted in* 1978 U.S.C.C.A.N. 6436, 6453; *see also* Statement by the Hon. Dennis DeConcini, Oct. 6, 1978, 124 Cong. Rec. S. 17406, *reprinted in* 1978 U.S.C.C.A.N. 6505, 6522 (introducing the House amendment to the Senate).

Thus, there is no indication in the legislative history that Congress's 1978 decision to allow debts obtained by false oral statements "respecting the debtor's . . . financial condition" to be dischargeable under § 523(a)(2)(A) was intended to work a substantive change in the law. That is, there is no indication in the legislative history that Congress intended to remove from the coverage of § 523(a)(2)(A) any of the debts based on oral misrepresentations going to financial condition that had been within the coverage of that provision's predecessors.

Thus, the legislative history of § 523(a)(2)(A) and (B) supports the strict reading of the phrase "respecting the debtor's . . . financial condition." There simply is no indication in the legislative history that Congress wished to exclude a large class of specific oral misrepresentations from the coverage of § 523(a)(2)(A). Indeed, it appears that § 523(a)(2)(B) and its predecessors were designed to provide an additional remedy for violations premised on the use of a fraudulent writing, not

undermine the coverage of § 523(a)(2)(A) and its predecessors.

C. Courts' Treatment of § 523(a)(2)(A) and (B)

Cases interpreting the phrase "respecting the debtor's . . . financial condition" have split on this issue. *See Schneiderman v. Bogdanovich (In re Bogdanovich),* 292 F.3d 104, 112–13 (2d Cir.2002) (collecting cases). However, we find the cases adopting the strict definition to be more persuasive.

1. Supreme Court

In *Field v. Mans,* 516 U.S. 59, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995), the court held that debts extended based on a debtor's oral fraudulent statements may be barred from being discharged under § 523(a)(2)(A) if a creditor "justifiably" relied on those statements, while debts extended based on a debtor's written financial statements may only be barred from being discharged under § 523(a)(2)(B) if a creditor "reasonably" relied on those statements. Although that decision did not address the issue directly, it lends some support to the notion that a statement "respecting the debtor's . . . financial condition" must relate to a debtor's overall financial health. In discussing § 523(a)(2)(A) and (B), the Court freely substituted the phrases "statement of financial condition" and "financial statement" for the phrase "statement respecting the debtor's . . . financial condition." "Statement of financial condition" and "financial statement" are terms with established meanings that involve an individual or entity's overall financial health. *See Black's Law Dictionary* (8th ed.2004) (defining "statement of condition" with a cross-reference to "balance sheet"—"[a] statement of an entity's current financial position, disclosing the value of the entity's assets, liabilities, and owners' equity"—and defining "financial statement" as "[a] balance sheet, income statement, or annual report that summarizes an individual's or organization's financial condition on a specified date or for a specified period by reporting assets and liabilities" or an "income-and-expense declaration"). Thus, the Court's substitution of these established phrases for the more unusual "statement respecting the debtor's . . . financial condition" implies that this unusual phrase should be given a meaning similar to that of the established phrases—not an expansive meaning that might embrace statements respecting only a single aspect of the debtor's financial condition.

Moreover, if the phrase "respecting the debtor's . . . financial condition" were given a broad reading, the resulting exclusion might eliminate coverage for many misrepresentations typical of the common-law torts that *Field* represents as lying at the heart of § 523(a)(2)(A). *See* 516 U.S. at 68–69, 116 S.Ct. 437 (noting that "the substantive terms in [§] 523(a)(2)(A) . . . refer to common-law torts" and stating that "[t]he operative terms in § 523(a)(2)(A) . . . 'false pretenses, a false representation, or actual fraud' carry the acquired meaning of terms of art"). Under the broad interpretation, debts incurred as a result of many of the fraudulent statements cited in the Restatement (Second) of Torts, *see Field,* 516 U.S. at 70, 116 S.Ct. 437, could not be excepted from discharge under § 523(a)(2)(A), since the fraudulent statements would qualify as "respecting the debtor's . . . financial condition" and therefore would be dischargeable. *See, e.g.,* Restatement (Second) of Torts (1976), § 525, illus. 3 (describing a seller's statement that stock shares will pay dividends within five years); *id.,* § 529, illus. 2 (describing a seller's statement that apartments in a building are rented to tenants at a particular rate, but neglecting to men-

tion that the rate has not been approved by rent control authorities, as a fraudulent misrepresentation); *id.*, § 540, illus. 1 (treating a seller's statement to a potential buyer that land is free from encumbrances as a fraudulent misrepresentation of fact).

2. Tenth Circuit

The Tenth Circuit has not directly addressed the question of how to interpret the phrase "respecting the debtor's ... financial condition." In *Bellco First Federal Credit Union v. Kaspar (In re Kaspar),* 125 F.3d 1358 (10th Cir.1997), we quoted a passage from a Fourth Circuit case that appeared to adopt a broad interpretation of the phrase "respecting the debtor's ... financial condition":

> "Congress did not speak in terms of financial statements. Instead it referred to a much broader class of statements—those 'respecting the debtor's ... financial condition.' A debtor's assertion that he owns certain property free and clear of other liens is a statement respecting his financial condition. Indeed, whether his assets are encumbered may be the most significant information about his financial condition. Consequently, the statement must be in writing to bar the debtor's discharge."

Id. at 1361 (quoting *Engler v. Van Steinburg (In re Van Steinburg),* 744 F.2d 1060, 1061 (4th Cir.1984)). However, while the Fourth Circuit decision quoted by *Kaspar* turned on whether a statement that an asset was not encumbered was a statement "respecting [a] debtor's ... financial condition," *Kaspar* cited the Fourth Circuit case only as part of its analysis that a statement must be in writing, and about a debtor's financial condition, for a debt incurred as a result of that statement to be nondischargeable under § 523(a)(2)(B). *See id.* at 1360–61. *Kaspar's* discussion of the quoted passage was limited to the statement that "[a]s noted in *Engler,* giving a statement of financial condition is a solemn part of significant credit transactions." *Id.* at 1361.

In any event, the debtors' statements in *Kaspar* likely would have qualified as "respecting the debtor[s'] ... financial condition" even under the strict definition of that phrase. The oral representations made by the debtors in *Kaspar* included representations as to the debtors' "financial condition, the name of [their] employer[s], [their] title[s], and salar[ies] .... the names of other creditors, the balances due on obligations owed those creditors as well as the monthly payments on the debts." *Id.* at 1359. Thus, while *Engler* indicates that a debtor's statement that an asset is unencumbered is enough to qualify as "respecting the debtor's ... financial condition," *Kaspar* does not go so far. Rather, *Kaspar* addresses only two debtors' statements that, because they contained general information about the debtors' overall financial health, would have qualified under the strict definition of the phrase "respecting the debtor's ... financial condition."

For these reasons, we view the question of how to interpret "respecting the debtor's ... financial condition" as an open issue in this circuit.

3. Other Courts

The trend and reasoning in other courts' decisions interpreting the phrase "respecting the debtor's ... financial condition" offer persuasive support for a strict reading of the phrase. *Chivers,* 275 B.R. at 606, succinctly summarizes the trend in these courts' efforts:

> The emerging viewpoint follows a strict interpretation. Although it does not require any specific formality, the strict interpretation limits an actionable statement of financial condition to finan-

> cial-type statements including balance sheets, income statements, statements of changes in financial position, or income and debt statements that provide what may be described as the debtor or insider's net worth, overall financial health, or equation of assets and liabilities. Cases supporting this view generally recite four arguments. First, they argue that the normal commercial meaning and usage of " 'statement' in connection with 'financial condition' denotes either a representation of a person's [an entity's] overall 'net worth' or a person's [an entity's] overall ability to generate income." Second, they cite to legislative history that references the statutes' application to the " 'so-called false financial statement.' " Third, they argue that the strict interpretation promotes better bankruptcy policy, because narrowing the definition of financial condition in § 523(a)(2)(B) necessarily expands those statements, both written and oral, that do not relate to financial condition that fall within § 523(a)(2)(A) and better harmonizes the statute. Finally, they argue that a strict interpretation is consistent with the historical basis of § 523(a)(2)(B), which was designed to protect debtors from abusive lending practices.

Id. at 615 (citations and footnotes in original omitted). The *Chivers* court went on to adopt the emerging, strict interpretation:

> [T]he strongest argument in favor of the broad interpretation—that had Congress wanted § 523(a)(2)(B) limited to false financial statements, it would have so drafted the statute—is gutted by the Supreme Court's repeated statements in *Field v. Mans* that § 523(a)(2)(B) refers to false financial statements. While it might be convenient to dismiss *Field's* repeated references to false financial statements as *dicta, Field's* meticulous comparison of §§ 523(a)(2)(A) and (B) does not lend itself to that interpretation. Rather, it makes it more difficult to dismiss as unintentional the recharacterization of "a statement in writing ... respecting ... financial condition" as a false financial statement. Lastly, *Field's* recitation of the history of § 523(a)(2)(B) and its goal of preventing abuse by consumer finance companies, which sometimes have encouraged false financial statements by their borrowers for the purpose of insulating their own claims from discharge, lends strong support for adoption of the strict interpretation.
>
> Therefore, the better approach is the strict interpretation of § 523(a)(2)(B) that requires a false written statement to describe the debtor's net worth, overall financial health, or ability to generate income. It is the most consistent with the Supreme Court's interpretation of the statute, it is consistent with the history of the reason for the creation of the statute, it strictly construes § 523(a)(2)(B) against the creditor and liberally in favor of the debtor, and it ... reconciles §§ 523(a)(2)(A) and (B) without impairing their effectiveness.

Id. at 615–16.

The Bankruptcy Court for the Southern District of New York has also propounded a *Chivers*-style justification for the strict approach:

> Under the so-called strict interpretation, [§ 523(a)(2)(B)] is limited to financial-type statements that are sufficient to determine the entity's overall financial responsibility, but no specific formality is required. These typically include balance sheets, income statements, statements of changes in financial position, or income and debt statements in the case of an individual wage earner,

that reflect a person's ability to pay an additional debt. By contrast, a statement relating to the financial condition of a single asset does not qualify.

Proponents of the strict view rely on the language used in the code, and point to its legislative history. They give "financial condition" its normal commercial meaning and usage. Further, the floor statements by Representative Edwards and Senator DeConcini, sponsors of the Bankruptcy Reform Act of 1978, indicate that the exception encompassed the use of the "so-called false financial statement." ...

Finally, the strict view promotes better bankruptcy policy. Virtually any statement concerning an asset or liability arguably relates to financial condition. If drawn too broadly, the definition will sweep in many oral misrepresentations, and therefore exclude them from coverage under subdivision (A). These debtors will thereby escape the anti-discharge provisions completely.

....

The arguments supporting the strict view are more persuasive [than those supporting the broad view]. [The arguments supporting the strict view] are consistent with ordinary usage and faithful to the intent of Congress as reflected in the statements of the sponsors. Moreover, the strict view better reflects the limited purpose that subdivision (B) was intended to serve. Subdivision (B) and its predecessors (dating back to 1903) were designed to protect debtors from abusive lending practices....

Th[ese] practice[s] gave the lender leverage to extract a settlement or reaffirmation, despite a weak case, from a debtor intent on avoiding litigation costs. Section 523(a)(2)(B) (and its predecessors) ... were intended to reduce the pressure on the honest debtor to settle. The lender must defend the adequacy of its lending form in the comparatively debtor-friendly bankruptcy court. Under § 523(d), the prevailing debtor may recover costs and attorneys fees from the creditor. Finally, § 523(a)(2)(B) requires proof of reasonable reliance, an objective standard. Hence, the lender's access to other information regarding the debtor's financial condition is relevant.

Admittedly, section 523(a)(2)(B) is not limited to extensions of credit by consumer finance companies or other lenders. It also applies where the debtor obtains goods or services. Nevertheless, it was designed to deal with a specific problem—tricking the debtor into presenting a false picture of his overall financial condition. Certainly, it was not intended to create an exception that swallowed up the general rule in subdivision (A). In this regard, virtually every statement by a debtor that induces the delivery of goods or services on credit relates to his ability to pay. The broad interpretation would permit many dishonest debtors to avoid the consequences of oral fraud. The better rule decides cases on their merits, rather than upon the construction of an ambiguous, statutory phrase that grants a fresh start without regard to the honesty of the debtor.

Weiss v. Alicea (In re Alicea), 230 B.R. 492, 502–04 (Bankr.S.D.N.Y.1999) (citations and footnotes in original omitted).

Given the smaller number of circuit court decisions interpreting the phrase "respecting the debtor's ... financial condition," discerning a trend in the circuit court decisions is difficult. As noted above, the Fourth Circuit appears to have adopted the broad interpretation, though it did so only in a brief 1984 opinion that it has never cited again. *See Engler,* 744

F.2d at 1061 ("A debtor's assertion that he owns certain property free and clear of other liens is a statement respecting his financial condition."). The Eighth Circuit's decision in *Rose v. Lauer (In re Lauer),* 371 F.3d 406, 413–14 (8th Cir. 2004) (finding a debt nondischargeable under § 523(a)(2)(A) because the debtors "committed garden variety common law fraud when they induced [the creditors] to sell their limited partner interests by concealing material changes in the [partnership's] asset mix"), provides support for the strict interpretation.[4]

Ultimately, we conclude that the trend cited by *Chivers* and the reasoning employed by *Chivers* and *Alicea* offer persuasive support for the strict reading.

D. Summary of Legal Analysis

For the above reasons, it appears that the strict reading of "respecting the debtor's . . . financial condition" is correct. It is the reading most consistent with the text and structure of the Bankruptcy Code, the legislative history of § 523(a)(2)(A) and (B), and case law. To state generally that we adopt a strict interpretation is not enough to resolve this case or to provide guidance to future courts, however; we must also define precisely the scope of the phrase "respecting the debtor's . . . financial condition."

[11, 12] Title 11, United States Code § 523(a)(2)(A) generally bars the discharge of the debts of an individual debtor to the extent that those debts were obtained by false pretenses, a false representation, or actual fraud. However, to the extent that those debts were obtained by the use of a false oral statement respecting the debtor's or an insider's financial condition, they are dischargeable. We hold that such false statements are those that purport to present a picture of the debtor's overall financial health. Statements that present a picture of a debtor's overall financial health include those analogous to balance sheets, income statements, statements of changes in overall financial position, or income and debt statements that present the debtor or insider's net worth, overall financial health, or equation of assets and liabilities. However, such statements need not carry the formality of a balance sheet, income statement, statement of changes in financial position, or income and debt statement. What is important is not the formality of the statement, but the information contained within it—information as to the debtor's or insider's overall net worth or overall income flow.

III. Application

In this case, the findings of the bankruptcy court indicate that Joelson made at least two types of representations. First, Joelson made representations as to her ownership of certain specific assets (the "Ownership Representations"). Second, Joelson made representations as to her intention and specific ability to obtain financing from her brother to repay Cadwell's loan (the "Repayment Representations").

[13] The Ownership Representations address only Joelson's ownership of certain assets. Thus, the Ownership Repre-

4. While the issue of how to interpret the phrase arose in two other circuit court cases, those courts did not definitively interpret the scope of the phrase. *See Bogdanovich,* 292 F.3d at 113–14 (refraining from adopting either the strict or the broad interpretation for justiciability reasons); *Berkson v. Gulevsky (In re Gulevsky),* 362 F.3d 961, 962–64 (7th Cir. 2004) (declining to address a bankruptcy court finding that "because [the debtor]'s misrepresentations were of his financial condition, and were oral, they were not actionable under any part of § 523(a)(2)").

sentations do not constitute a statement as to Joelson's overall financial health analogous to a balance sheet, income statement, statement of changes in financial position, or income and debt statement. Therefore, the Ownership Representations do not qualify as "respecting the debtor's … financial condition" under the strict definition of that phrase. *See Lauer,* 371 F.3d at 413–14; *Bal–Ross Grocers, Inc. v. Sansoucy (In re Sansoucy),* 136 B.R. 20, 23 (Bankr.D.N.H.1992) ("[A]n oral misrepresentation that certain collateral was free and clear of any liens [i]s actionable under 523(a)(2)(A).").

[14] Similarly, the Repayment Representations are not a statement as to Joelson's overall financial health. Joelson's representation to Cadwell that Cadwell would be able to look to Joelson's brother for repayment is analogous to Joelson's representation to Cadwell that she owned one particular asset. Just as a statement about one of Joelson's assets is not a statement that reflects Joelson's overall financial health, and therefore does not "respect[ ] the debtor's … financial condition," a statement about one part of Joelson's income flow—the flow of funds from her brother—does not reflect Joelson's overall financial health. Therefore, the Repayment Representations also are not "respecting the debtor's … financial condition."

Because the Ownership and Repayment Representations do not constitute statements "respecting [Joelson's] financial condition," the state court judgment on Cadwell's loan to Joelson is not dischargeable under § 523(a)(2)(A). Thus, the bankruptcy court and BAP correctly held that the debt owed by Joelson to Cadwell is nondischargeable under § 523(a)(2)(A).[5]

CONCLUSION

For the foregoing reasons, we AFFIRM the judgment of the BAP.

HARTFORD INSURANCE COMPANY OF THE MIDWEST; Interstate Indemnity Insurance Company, Plaintiffs–Counter–Defendants–Appellees,

v.

Charles D. CLINE; Judith E. Davis, Defendants–Counter–Claimants–Appellants.

No. 05–2075.

United States Court of Appeals, Tenth Circuit.

Oct. 12, 2005.

Mark Stout, Stout & Stout, Hobbs, NM, Barry Crutchfield, Templeman and Crutchfield, Lovington, NM, Michael B. Browde, Albuquerque, NM, for Appellants.

Kelley J. Friedman, Larry D. Beall, Beall & Biehler, Matthew A. Pullen, April

5. Debtor also represented that she and Joelene Joelson are the same person (the "Identity Representation"). We refrain from addressing whether the Identity Representation is sufficient to render the state court judgment nondischargeable. Because the bankruptcy court was unable to conclude "whether Jolene or Joelene is simply a name used by [Debtor] or a different person entirely," it is not clear whether the Identity Representation was a false representation as defined by § 523(a)(2)(A) that would bar the state court judgment from being discharged, and we may not attempt to resolve this factual issue. *See Novelly v. Palans (In re Apex Oil Co.),* 960 F.2d 728, 731 (8th Cir.1992) ("If we conclude that the bankruptcy court's findings are silent or ambiguous as to an outcome determinative factual question, we may not make our own findings….").

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Hon. John E. Hoffman, Jr.
United States Bankruptcy Judge
Southern District of Ohio

Bankruptcy Law Letter

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A New *Millennium* of Article III Analysis: Which Court—a Bankruptcy Court or a District Court—Must Decide Whether to Confirm a Plan that Contains a Nonconsensual Third-Party Release? (Part I)

*By Ben H. Logan**

Author's note: Prior to my retirement on January 1, 2015, I was a partner in O'Melveny & Myers LLP. While at O'Melveny, I was part of the team that represented the debtor before the Court in Wellness International Network, Ltd. v. Sharif, 135 S. Ct. 1932 (2015). I mention this since it is conceivable that, notwithstanding my best efforts to the contrary, this colors my analysis. None of the views expressed herein should be ascribed to O'Melveny, its clients or, indeed, anyone other than me personally. In addition, I reserve the right to change my mind at the drop of a hat.

I am deeply indebted to Professor Ralph Brubaker, the Editor in Chief of this publication, for his input. However, the views expressed herein definitely should not be ascribed to him. Ralph and I have sparred publicly over Article III jurisdictional issues and have carried on an extensive private dialogue. Ralph has written expansively and thoughtfully on third-party releases and bankruptcy jurisdiction. It is with substantial trepidation that I write on these topics in his publication, particularly since he and I disagree in some respects. School of Law.

Introduction (Part I)

Article III of the Constitution provides that the "judicial Power of the United States" shall be exercised by one Supreme Court and such inferior courts as are established by Congress. Article III also requires that the judges of those courts "hold their offices during good Behaviour, and shall, at stated Times, receive for their Services a Compensation which shall not be diminished during their Continuance in Office."[1] The approximately 350 judges who serve on our bankruptcy courts have neither the life tenure nor salary protection that are the

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attributes of Article III courts. Ever since the Court decided *Marathon*,[2] courts have struggled to determine what decision-making authority (if any) may Congress constitutionally assign to these non-Article III bankruptcy courts. Unlocking this puzzle is extraordinarily difficult but incredibly important for it is "no exaggeration to say that without the distinguished service of these judicial colleagues, the work of the federal court system would grind nearly to a halt."[3]

On October 3, 2017, Judge Silverstein of the Bankruptcy Court for the District of Delaware issued an important decision exploring the contours of what is permissible under Article III. In *Millennium Lab Holdings II, LLC,* [4] she held that it is constitutional for a non-Article III bankruptcy court to issue a final order confirming a chapter 11 plan of reorganization that contains a release of claims that a creditor has against a non-debtor defendant— i.e., a nonconsensual third-party release.[5] This case has attracted wide attention[6] for these issues are largely untested and arise frequently.

Third-party releases are extremely controversial, resulting in extensive litigation and volumes of scholarly articles. For example, the Editor-in-Chief of this publication, Professor Brubaker, has argued extensively that a court—whether it be a non-Article III bankruptcy court or a district court exercising bankruptcy jurisdiction—does not have authority[7] to confirm a plan containing a nonconsensual third-party release.[8] There is also a contrary view and it is the majority view among the circuits. The Circuit Courts for the Fifth, Ninth and Tenth Circuits have held that the Bankruptcy Code does not authorize confirmation of a plan containing a third-party release,[9] while their colleagues in the First, Second, Third, Fourth, Sixth, Seventh, Eleventh, and D.C. Circuits have come to the opposite conclusion.[10]

To the extent possible, this article leaves those debates to others. Instead, this article explores *which* court, a non-Article III bankruptcy court or a district court exercising bankruptcy jurisdiction, must decide whether to confirm such a plan (or at least the part of the plan that contains the nonconsensual third-party release). As Judge Silverstein put it, the constitutional issue is "the division of labor between the bankruptcy and district courts."[11]

Obviously, Judge Silverstein is bound by the decisions of the Third Circuit Court of Appeals regarding whether a plan can contain a nonconsensual third-party release. Her reading of

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these cases indicates that the Bankruptcy Code authorizes confirmation of a plan that contains such a release if certain tests are met.[12] Whether that is a correct interpretation of Third Circuit law and whether under that interpretation of Third Circuit law the specific plan considered in *Millennium* should have been confirmed are important questions. But those questions are different than the Article III issue addressed in this article—i.e., *which* court, the non-Article III bankruptcy court or the district court, must decide these issues.

The answer to the constitutional question depends largely on whether one perceives a court as (1) confirming a chapter 11 plan pursuant to the court's jurisdiction to deal with matters "arising under" the Bankruptcy Code and matters "arising in" a bankruptcy case, or (2) disposing of a third-party claim pursuant to the court's "related to" jurisdiction over that third-party claim. In Part I of this article, I explain why the majority view—i.e., that a plan containing a nonconsensual third-party release can be confirmed—should be analyzed as an exercise of "arising under/arising in" jurisdiction. That foundation is important for the exercise of "related to" jurisdiction to decide the merits of the third-party claims would not provide a solid statutory or constitutional basis for a non-Article III bankruptcy court to decide whether to confirm a plan containing a nonconsensual third-party release.

Part II, to be published in next month's issue of the *Bankruptcy Law Letter*, will explore why the exercise of this jurisdiction by a non-Article III bankruptcy court is constitutional.

Millennium Lab is an important case. But it is hardly unique. For at least the last 80 years,[13] bankruptcy plans of reorganization have purported to release third-party claims. Since the majority view is that the Bankruptcy Code allows confirmation of a plan containing a nonconsensual third-party release, we should expect that courts will continue to be presented with such plans. Yet until recently, relatively little attention was paid to the constitutional question. This is surprising since 17 years ago the Third Circuit Court of Appeals flagged this "very significant issue"—whether the Constitution requires that an Article III court must decide whether to confirm a plan containing a nonconsensual third-party release.[14]

I. The Facts and Issues in *Millennium Lab*

Although the issues have importance far beyond *Millennium Lab,* a brief review of the case will help set the stage.

The debtors are in the healthcare business and derive much of their income from Medicare and Medicaid reimbursements.[15] "As early as 2012, the United States Department of Justice" launched "joint criminal and civil investigations into Millennium."[16] And in early 2015, the Centers for Medicare & Medicaid Services notified the debtors that it intended to revoke their Medicare billing privileges.[17] Without a resolution of these issues, Millennium's business was not viable —in addition to substantial government monetary claims, the loss of Medicaid billing privileges "would have destroyed the Debtors' business."[18] So in May 2015, Millennium and the government reached an agreement in principle in which Millennium agreed to pay the government approximately $250 million.

The debtors then turned to their major stakeholders, including the lenders under a $1.825 billion senior secured credit facility. Those negotiations resulted in a restructuring support agreement that provided, *inter alia*, that (1) the debtors would pay the federal government $256 million, (2) $1.825 billion of senior secured debt would be converted into $600 million of new term loans, an interest in a litigation trust and 100% of the equity in the reorganized debtors, (3) all other creditors would receive a 100% recovery, and (4) the

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institutions that held Millennium's prepetition equity would contribute $325 million of cash.[19] This $325 million would fund the $256 million paid to the federal government, $50 million paid to certain of the prepetition lenders, and $19 million of working capital.[20] In return, the prepetition equity holders insisted on a full release of all claims that might be asserted against them related to the debtors.[21] Without this agreement—which the debtors characterized as a "global settlement"—the debtors "would have been forced to liquidate."[22]

When the debtors filed their chapter 11 petitions on November 10, 2015, they also filed a plan and disclosure statement.[23] That plan was accepted by more than 93%, in terms of number and amount, of the claims of the prepetition lenders.[24] But that support was not unanimous.

The plan was opposed by funds managed by Voya Investment Management Co. LLC and Voya Alternative Asset Management LLC (collectively "Voya") which held 5.8% of this debt.[25] On December 4, 2015, Voya filed broad objections to the plan.[26] And five days later, Voya filed litigation in district court asserting common law fraud and RICO claims against the prepetition equity holders plus two corporate executives.[27] In this fraud and RICO litigation, Voya asserted that the defendants had caused the debtors to make false representations and warranties in the April 2014 loan agreement—representations and warranties that Millennium was not the subject of material litigation or investigations and had not suffered a material adverse effect. Identical third-party claims presumably could have been asserted by each of the other lenders (i.e., all the creditors in Voya's class), but Voya was alone in filing this litigation and in objecting to the plan. None of the defendants was a debtor in the bankruptcy case, but each defendant was a beneficiary of the third-party release contained in the plan.

On December 11, 2015, Judge Silverstein issued a bench ruling confirming the plan. At that time, she did not conduct a thorough analysis of the nature of her jurisdiction, instead concluding that she "at least" had "related to" jurisdiction. Voya appealed the confirmation order to the district court, listing six issues for appeal, none of which mentioned the Constitution, *Stern v. Marshall*[28] or any of the Court's other Article III decisions. But Voya did raise one jurisdictional question—"Can Bankruptcy Courts exercise 'related to' jurisdiction over a non-debtor's direct claims against other non-debtors for fraud and other willful misconduct on the basis of contractual indemnification agreements by the debtor of the other non-debtors that expressly and/or as a matter of law preclude indemnification for acts of fraud, wilful [sic] misconduct, and violations of the Racketeer Influenced and Corrupt Organization (RICO) Act."[29] In other words, Voya challenged whether the bankruptcy court had "related to" jurisdiction.

As a result, on appeal, the district court operated on the premise that jurisdiction was, at best, "related to."[30] At this stage, the jurisdictional and constitutional issues that have since come to the fore had received relatively little attention. Thus, when the case was before the district court last spring, District Judge Stark had a relatively sparse record. Based on what he had at the time, he intimated that a bankruptcy court must exercise "related to" jurisdiction in order to confirm a plan containing a third-party release and expressed skepticism that a non-Article III bankruptcy court can issue a final order confirming such a plan. But because the nature of the bankruptcy court's jurisdiction and the related constitutional issues had received little attention when Judge Silverstein confirmed the plan, Judge Stark remanded to Judge Silverstein with instructions to consider whether a bankruptcy court has constitutional authority to approve a plan containing a third-party release.[31]

After these issues were remanded to the

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bankruptcy court, the parties briefed and argued them extensively. On October 3, 2017, Judge Silverstein issued her decision in which she concluded that it is constitutional for her to decide whether to confirm the *Millennium* plan.

On October 16, 2017, Voya again appealed to the district court, so Judge Stark will have a second opportunity to grapple with these issues. Time will tell whether he will modify the views he expressed last spring. Alternatively, he could duck the constitutional and jurisdictional issues, for Judge Silverstein's latest decision includes alternative holdings that Voya consented to bankruptcy court jurisdiction and/or forfeited its ability to raise these issues.[32] Principles of constitutional avoidance suggest that deciding the appeal on those grounds might well be the wiser course.

But even if there are no further decisions in *Millennium* dealing with the constitutional issues, other courts will undoubtedly need to wrestle with them. As noted at the outset of this article, the majority view is that a chapter 11 plan can include a third-party release and it is not likely that parties opposing such plans in the future will miss the constitutional issues.

II. The Type of Bankruptcy Jurisdiction that a Court Exercises and Article III of the Constitution; Different but Related Issues

Let me again emphasize that I do not intend to join the already extensive debate over whether the Bankruptcy Code authorizes any court to confirm a plan containing a third-party release. For purposes of this article, I assume that this authority exists. The answer to the constitutional question—*which* court must decide whether to confirm a chapter 11 plan—depends largely on whether one views the court's task to be (1) determining whether a plan that contains a third-party release satisfies the standards for confirmation set forth in the Bankruptcy Code, or (2) exercising "related to" jurisdiction over the third-party claim.

The Judicial Code sets forth the scope of bankruptcy jurisdiction in 28 U.S.C.A. § 1334. Section 1334(a) provides that "except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11."[33] Section 1334(b) then provides that a federal court exercising bankruptcy jurisdiction has "original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11."

Section 1334(b) is usually parsed into jurisdiction of matters (1) "**arising under**" the Bankruptcy Code, (2) "**arising in**" a bankruptcy case, or (3) "**related to**" a bankruptcy case.

Jurisdiction "arises under" title 11 when "the Bankruptcy Code itself creates the cause of action."[34] When the Bankruptcy Code is the source of the relevant substantive law, a reorganization court has "arising under" subject matter jurisdiction over a proceeding.[35]

" '[A]rising in' proceedings generally [are] 'those that are not based on any right expressly created by title 11, but nevertheless, would have no existence outside of the bankruptcy.' "[36] "[C]laims that 'arise in' a bankruptcy case are claims that by their nature, not their particular factual circumstance, could only arise in the context of a bankruptcy case." [37]

The scope of the third type of bankruptcy jurisdiction—"related to" jurisdiction—is very broad. As discussed below, it generally involves non-bankruptcy law and extends to disputes in which the debtor is not a party.

The allocation of the exercise of this bankruptcy jurisdiction between the district courts, sitting in bankruptcy, and the non-Article III bankruptcy courts is governed by 28 U.S.C.A. § 157. To start with, 28 U.S.C.A. § 157(a)

authorizes each district court to refer all bankruptcy cases and all proceedings within the scope of bankruptcy jurisdiction set forth in 28 U.S.C.A. § 1334(b) to the bankruptcy judges for the district. Section 157(b)(1) provides that bankruptcy judges can issue final decisions in "core proceedings arising under title 11, or arising in a case under title 11." Section 157(c) requires a different path for "a proceeding that is not a core proceeding but that is otherwise related to a case under title 11"—unless the parties consent, the bankruptcy judge can hear the matter but must submit proposed findings of fact and conclusions of law to the district court for *de novo* review.

So which is it—"related to" jurisdiction or "arising in/arising under" jurisdiction? Many courts that have considered whether such a plan should be confirmed have punted by holding that the bankruptcy court has *either* "related to" or "arising in/arising under" jurisdiction. But when one focuses on the requirements of Article III and the statutory allocation of jurisdiction between bankruptcy courts and district courts, it makes a difference.

III. The Starting Point: What Sort of Bankruptcy Jurisdiction?

A. The Misconception that it is "Related To" Jurisdiction Over the Third-Party Claim

The relevant question is whether the Bankruptcy Code authorizes confirmation of a plan containing a nonconsensual *release* of a third-party claim, as opposed to whether a court should exercise "related to" jurisdiction to determine *the merits of* that third-party claim. This distinction is critically important for it is the guidepost as to whether jurisdiction is "arising in/arising under" or instead is merely "related to." And the type of jurisdiction that a court exercises makes a critical difference as to whether a non-Article III bankruptcy court can issue a final decision (absent consent) or must submit proposed findings of fact and conclusions of law.

This follows for two reasons.

First, this is probably what 28 U.S.C.A. § 157 requires. Section 157(b)(1) provides that a bankruptcy judge may issue final decisions in "core proceedings **arising under** title 11, or **arising in** a case under title 11." In contrast, when a bankruptcy court exercises "**related to**" jurisdiction, 28 U.S.C.A. § 157(c)(1) provides that (absent consent) a bankruptcy judge is restricted to submitting proposed findings of fact and conclusions of law to the district court for *de novo* review.[38]

There is a contrary interpretation of the statute. One of the teachings of *Stern* and *Arkison* is that Congress failed to craft 28 U.S.C.A. § 157 in a manner that captured what it undoubtedly intended. Professor Brubaker makes this point when he explains, "the core-jurisdiction statute was overtly designed to give non-Article III bankruptcy judges as much final-judgment jurisdiction as is constitutionally permissible (but no more)."[39] He then argues that "after the Supreme Court's decisions in *Stern* and *Arkison*, it is now clear that that the determinative inquiry in deciding whether a particular proceeding is core or noncore is (with only one exception) entirely a constitutional one."[40] If he is correct, a bankruptcy court can enter a final judgment (without consent) in a matter where the jurisdiction is "related to" if that passes muster under the Constitution.

So what does the Constitution require? As will be explored in Part II of this article, if jurisdiction is founded simply on a bankruptcy court's "related to" jurisdiction to adjudicate the merits of a third-party claim, there is no credible articulation of the constitutional scope of non-Article III jurisdiction that would allow Congress to authorize a bankruptcy court to enter a final judgment (absent consent).[41]

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A court—either a bankruptcy court or a district court exercising bankruptcy jurisdiction—*could* exercise "related to" bankruptcy jurisdiction to adjudicate the merits of most third-party claims that are released in chapter 11 plans. As the Court explained in *Celotex Corp. v. Edwards*, "[p]roceedings 'related to' the bankruptcy include . . . suits between third parties which have an effect on the bankruptcy estate."[42] Or phrased differently, "related to" jurisdiction requires that there must be "some nexus between the civil proceeding and the title 11 case."[43] That nexus should exist in a chapter 11 plan that contains a third-party release for the courts that authorize nonconsensual third-party releases require that there be an "identity of interest between the debtor and the third party. . . such that a suit against the non-debtor is, in essence a suit against the debtor or will deplete the assets of the estate."[44] As a result, a court could exercise "related to" jurisdiction to determine the merits of the sort of claims between non-debtors that are released in chapter 11 plans.

So *if* Voya had filed its third-party litigation in the bankruptcy court or the district court where Voya filed this litigation had referred it to the bankruptcy court, the *Millennium* bankruptcy court *could* have exercised "related to" jurisdiction over Voya's common law fraud and RICO claims against Millennium's shareholders, officers and directors. *If* the bankruptcy court had exercised "related to" jurisdiction over these third-party causes of action, it would have operated under the full procedural rules applicable to non-bankruptcy civil litigation, would have considered the merits of the claims, and would have submitted to the district court proposed findings of fact and conclusions of law dealing with the elements of common law fraud and RICO and any defenses the non-debtor defendants raised. But that is *not* what was before the bankruptcy court and, accordingly, it is *not* what actually happened.

Rather the bankruptcy court addressed a different set of issues—whether it was proper under the Bankruptcy Code to confirm the chapter 11 plan before it.[45] So if the Constitution or statutory grant of jurisdiction had required Judge Silverstein to submit proposed findings and conclusions of law to the district court, they would have dealt with whether this plan, including the third-party release, should be confirmed under chapter 11 of the Bankruptcy Code and Third Circuit decisions interpreting the Bankruptcy Code, not whether Voya had valid common law fraud and RICO claims against the non-debtor defendants.

Confirmation of such a plan will have a preclusive effect on these third-party claims, but that does not mean that the court exercised "related to" jurisdiction to decide the merits of the third-party claims. The Court illustrated this point in *Stoll v. Gottlieb*.[46] In *Stoll v. Gottlieb*, the debtor filed a plan of reorganization under § 77B of the Bankruptcy Act of 1898 that "canceled" a guarantee by a non-debtor (Stoll) in favor of a creditor (Gottlieb). The bankruptcy court[47] concluded that § 77B authorized it to confirm this plan and did so. In reaching that conclusion, the bankruptcy court did not address the merits of Gottlieb's claims against Stoll on the guarantee; indeed, the guarantee was probably valid. Rather, the bankruptcy court determined that § 77B of the Bankruptcy Act of 1898 gave it "power or jurisdiction to *cancel* the guaranty."[48] This was not an exercise of "related to" jurisdiction over the third-party claim. Indeed, "related to" jurisdiction was not even a recognized concept under the 1898 Act.[49]

After the bankruptcy court confirmed the plan, Gottlieb sued the guarantor in state court. The Court famously disallowed that collateral attack and held that *res judicata* barred this state court litigation. The Court's decision was not based on any assertion that the bankruptcy court had determined the merits of the claim on the guarantee —that court had not

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even addressed those merits and there is no indication that the state law guarantee claim was invalid—much less exercised "related to" jurisdiction over this third-party claim.[50] Instead, the bankruptcy court's jurisdictional determination was premised on its perception of the authority granted it by § 77B of the 1898 Act—what we would call today "arising under" or "arising in" jurisdiction. The Court gave *res judicata* effect to the bankruptcy court's determination that § 77B gave it authority to cancel the claim. The bankruptcy court might well have been wrong in its interpretation of the provisions of the 1898 Bankruptcy Act, but as the Court explained, since "in an actual controversy the question of jurisdiction over the subject matter [i.e., whether the 1898 Bankruptcy Act gave a reorganization court "power or jurisdiction to cancel the guaranty"] was raised and determined adversely to the respondent . . . [t]hat determination is *res judicata* of that issue in this action, whether or not power to deal with the particular subject matter was strictly or quasi-jurisdictional."[51]

Just like the guarantee in *Stoll v. Gottlieb*, the third-party claims released in the *Millennium* plan might (or might not) have been valid. Moreover, the relevant law governing those claims—common law fraud and RICO in *Millennium*—would not provide a basis for *any* court to dismiss these claims over Voya's objection without addressing the merits. Instead, authority to approve a nonconsensual third-party release contained in a plan must be founded on bankruptcy law—"arising in" or "arising under" jurisdiction—rather than "related to" jurisdiction over the claims to be released, the merits of which are governed by non-bankruptcy law.

An order confirming a plan that includes a third-party release has a major (indeed probably dispositive) *impact* on that claim. That is because courts in circuits that follow the majority view have concluded that bankruptcy law gives a bankruptcy court authority to "cancel"[52] the third-party claim, not because the court exercises "related to" jurisdiction to deal with the merits of the third-party causes of action. If a creditor believes that the bankruptcy court was wrong with respect to this aspect of bankruptcy law, it is free to appeal. And if the creditor lets the confirmation order become final, the confirmation order will be given preclusive effect in the third-party litigation.[53]

In her October 3, 2017 decision, Judge Silverstein deals extensively with this issue.[54] It is a linchpin of much of what follows, so it was appropriate that she undertook substantial analysis in reaching the conclusion that the fact that a confirmation order will have a preclusive impact on a third-party claim does not transform a confirmation hearing—a prototypical exercise of "arising under" or "arising in" jurisdiction involving matters of bankruptcy law—into a "related to" exercise of jurisdiction over the third-party claim. She got it right.

As she points out, other courts have reached the same conclusion. For example, in *In re AOV Industries*,[55] the D.C. Circuit dealt with a plan that contained a third-party release. Certain creditors argued that the bankruptcy court could not constitutionally exercise "related to" jurisdiction over these third-party claims between two non-debtors.[56] The D.C. Circuit rejected the foundation of this argument. As the court explained, the bankruptcy court was not exercising "related to" jurisdiction over these third-party claims; rather, it was tasked with deciding whether the plan passed muster under the confirmation standards set forth in chapter 11, and "approval of a disclosure statement and confirmation of a reorganization plan are clearly proceedings at the core of bankruptcy law."[57] The fact that confirmation would have a preclusive impact on those third-party claims did not change the analysis. "Although the bankruptcy

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court's decision may have an impact on claims outside the scope of the immediate proceedings, we do not read *Marathon* and its progeny to prohibit all bankruptcy court decisions that may have tangential effects. The expansive reading of *Marathon* urged on us . . . would limit the power of these Article I courts to a far greater degree than we believe Congress or the Supreme Court intended."[58]

The decision in *In re Charles Street African Methodist Episcopal Church of Boston*[59] also illustrates this point. The plan there provided that a non-debtor's guarantee of certain claims against the debtor would be released. The court explained that the "matter before the Court is not a suit on the Guaranty; the merits of the Guaranty are not in controversy."[60]

In sum, a nonconsensual release of a third-party claim may have the same *effect* as ruling against the plaintiff based on a consideration of the merits of that claim. But while the result is the same, the jurisdictional foundation is very different, as are the substantive issues that the court is to consider.

None of this is to say that it would be proper for a bankruptcy court (or even a district court) to confirm a plan that released a third-party claim that was unrelated to the debtor or the bankruptcy case. As explored in the next section of this article, the confirmation standards set forth in the Bankruptcy Code, particularly the best interests test, require a substantial "identity of interest" between the claims that the objecting creditor asserts against the debtor and the claims that this creditor asserts against the non-debtor, such that the third-party claims are in essence claims against the debtor. Indeed, the best interests test requires that the damages asserted in the creditor's claim against the debtor be interdependent with the damages asserted in the creditor's claim against the third-party.[61] In addition, without a high degree of "relatedness," confirmation of a plan that contains a third-party release would not fit the Court's articulations of the scope of bankruptcy jurisdiction that can constitutionally be delegated to a bankruptcy court—otherwise, the provisions of the plan containing the third-party release would not be "integral to restructuring the debtor-creditor relations" and the argument that the release "stems from the bankruptcy itself" would be attenuated. Part II of this article deals with the application of these constitutional principles to confirmation of a plan that contains a third-party release, so more on this topic next month.

In a generic sense, this requirement of a high degree of "relatedness" means that a court that confirms a plan with a third-party release deals with a claim that is "related to" a bankruptcy case. But that is not an exercise of "related to" jurisdiction in the sense that this terminology is used in the Judicial Code. When federal courts exercise "related to" bankruptcy jurisdiction over non-bankruptcy claims asserted by the debtor against third parties or claims asserted between two non-debtors, they take control over litigation that has a plaintiff and a defendant, operate pursuant to the normal rules of civil procedure, and decide the merits of the claims.[62] After all, litigation of the merits of the debtor's contract claim against a third-party was what was at issue in *Marathon* and litigation of the merits of the debtor's tort counterclaim against a creditor was what was at issue in *Stern*.

Indeed, if one concluded that the phraseology "related to" used in the Judicial Code should be stretched to include this situation, it would be constitutional for a bankruptcy court to exercise that jurisdiction for the issues all "stem from the bankruptcy itself," are part of an omnibus collective bankruptcy proceeding, and have no corollary in the common law—the topic covered in Part II of this article.[63]

B. Jurisdiction that "Arises Under" the Bankruptcy Code or "Arises In" a Bankruptcy Case

The constitutional analysis to be set forth next month in Part II depends in large measure on whether courts that follow the majority view—i.e., that a chapter 11 plan can contain a third-party release if certain tests are met—base that conclusion on the Bankruptcy Code as opposed to general equitable principles. So the following section of this article explores the statutory basis for the majority view.

Before starting that part of the journey, I need to emphasize (again) that I am not trying to demonstrate that the majority view is correct as a matter of bankruptcy law—there are strong arguments that it is not. Nor am I trying to demonstrate that the statutory basis for the majority view has been developed fully by all the courts that follow this line of cases—many of these decisions lack precision in their analysis. Nor am I trying to demonstrate that Judge Silverstein was correct in concluding that the specific plan before her in *Millennium* should have been confirmed.[64]

Rather, in order to explore the constitutional question, it is appropriate to set forth the argument as to why the Bankruptcy Code, rather than illusive equitable principles, authorizes a court to confirm a chapter 11 plan that contains a third-party release.

1. The Majority View is That Bankruptcy Code § 524(e) Does Not Determine Whether a Plan Containing a Third-Party Release can be Confirmed

Bankruptcy Code § 524(e) provides that the "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." The minority view, held by the Fifth, Ninth and Tenth Circuits, is that § 524(e) prohibits confirmation of a plan that contains a third-party release.[65] Even in jurisdictions that follow the minority view, presumably it will be bankruptcy courts that deny confirmation. Deciding not to confirm a plan will be a relatively simple matter for a bankruptcy court in one of these Circuits, but it will still be an exercise of "arising under" or "arising in" jurisdiction.

The majority view is that the mere fact that § 524(e) provides that the debtor's discharge does not itself release a claim against a co-debtor does not mean that some other provision of the Bankruptcy Code prevents a court from approving a plan that contains a third-party release. As the Seventh Circuit explained, the "natural reading of this provision does not foreclose a third-party release from a creditor's claims. . . Section 524(e) is a savings clause; it limits the operation of other parts of the bankruptcy code and preserves rights that might otherwise be construed as lost after the reorganization. . . .In any event, § 524(e) does not purport to limit the bankruptcy court's powers to release a non-debtor from a creditor's claims."[66] Or as the Eleventh Circuit put it, "§ 524(e) says nothing about the authority of the bankruptcy court to release a non-debtor from a creditor's claims."[67]

Even some of the strongest critics of third-party releases agree. For example, although Professor Brubaker contends that a court does not have authority to approve a third-party release, he points out that this conclusion cannot be founded on § 524(e). "Nothing in § 524(e) can be read to affirmatively prohibit a bankruptcy court" from approving a third-party release.[68] The "[p]reoccupation with the interpretational debate over § 524(e)" has created a diversion.[69] It is a red herring.

2. Bankruptcy Code § 105 is not Sufficient, *in and of Itself*, to Establish "Arising Under" or "Arising In" Jurisdiction

Bankruptcy Code § 105(a) provides that the

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"court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." Some courts have relied on the broad grant of equitable powers contained in § 105(a) to conclude that a reorganization court has "arising under" or "arising in" jurisdiction to approve a chapter 11 plan containing a third-party release.[70] As explained below, these cases are built on a weak jurisdictional foundation.

The breadth of the equitable powers conferred by § 105(a) has been the subject of substantial litigation, including a raft of cases in which the Court has rejected some of the more expansive interpretations of the equitable powers described obliquely in § 105(a).[71] As the Court put it in *Norwest Bank Worthington v. Ahlers*, "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code."[72]

There are two schools of thought regarding the reach of § 105. The narrow view points out that "Section 105 uses the term 'provisions' and not the term 'purposes' in describing a court's power to effect the mandate of the Bankruptcy Code. The statutory language thus suggests that the exercise of section 105 power be tied to another Bankruptcy Code section and not merely to a general bankruptcy concept or objective."[73] Courts that hew to this narrow view emphasize that § 105(a) "does not authorize bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law, or constitute a roving commission to do equity."[74] Instead they hold that the exercise of § 105 powers is appropriate only when tethered to another section of the Bankruptcy Code.

In contrast, the broad view "recognizes that certain goals of the Bankruptcy Code are implied but not stated in statutory language, and views § 105 as granting courts authority to fill the gaps left by the statutory language."[75] Even courts adopting the broad view acknowledge that § 105 cannot be used to contravene another provision of the Bankruptcy Code or "any other state or federal statute."[76]

The divide between the narrow and broad view of § 105 largely relates to how closely the use of § 105 must be tethered to another aspect of the Bankruptcy Code —the narrow view holding that the order must be tethered to another specific section of the Bankruptcy Code while the broad view contends that it can be tethered either to the purposes of the Bankruptcy Code or a court's inherent ability to "police [its] dockets and afford appropriate relief."[77]

But regardless of that debate, § 105, *standing alone*, cannot confer "arising under" or "arising in" jurisdiction.[78] "Section 105 . . . is not an independent source of jurisdiction, a notion that § 105(c) now makes explicit."[79] As a result, when it remanded this matter to the bankruptcy court, the *Millennium* district court got it right when it observed that "even if Bankruptcy Code § 105 provides statutory authority for [a] Bankruptcy Court to approve third-party release, '[section] 105 does not provide an independent source of federal subject matter jurisdiction. . ..'"[80]

3. "Arising Under" and "Arising In" Jurisdiction Founded on Bankruptcy Code §§ 1122, 1123(a)(5), 1123(b)(6), 1126 and 1129

a. The Statutory Framework

A number of cases that hold that a reorganization court[81] has authority to confirm a plan containing a third-party release have tethered § 105 to Bankruptcy Code §§ 1123(a)(5) and/or (b)(6), as well as the other sections in chapter 11 setting forth the standards for confirmation of a plan.

Section 1123(a)(5) provides that a plan "shall provide adequate means for its implementa-

tion, such as" retention or transfer of property of the estate, a merger of the debtor with a third party, satisfaction or modification of a lien, sale of all or any property of the estate (subject to liens or free and clear), cancellation or modification of any indenture or similar instrument, curing or waiving any default, modification of the maturity date and/or interest rate of outstanding securities, amendment of the debtor's charter, and the issuance of new securities. The matters listed in § 1123(a)(5) "are clearly illustrative and not exclusive."[82]

Section 1123(b)(6) provides that a plan "may . . . "include any other appropriate provision not inconsistent with the applicable provisions of this title."

The Sixth Circuit in *Dow Corning*[83]and the Seventh Circuit in *In re Airadigm Communications*[84] held that 1123(b)(6) coupled with 105(a), gives a court "arising under" or "arising in" jurisdiction to confirm a plan containing a nonconsensual third-party release. Lower courts in other circuits have also adopted this analysis,[85] as have some commentators.[86] The courts that hew to this view then turn to whether the specific plan in question should be confirmed—i.e., does it satisfy the confirmation standards set forth in chapter 11 and the relevant case law.

Perhaps this approach was explained most clearly in *Charles Street*.[87] The plan there provided for the release of a third-party guarantee. The court pointed out that the merits of the guarantee were not at issue.[88] Thus, the question was not whether the bankruptcy court had "related to" jurisdiction over a claim on the guarantee. Rather, the question was whether the bankruptcy court had "arising under" jurisdiction to confirm a plan. That was a question the court could answer "without recourse to its related-to jurisdiction."[89] And to determine whether the third-party release was within the bankruptcy court's "arising under" jurisdiction the bankruptcy court considered whether the third-party release was "an appropriate provision" for a chapter 11 plan—to use the phraseology of § 1123(b)(6)—and whether the plan, with the third-party release, was confirmable under the provisions of chapter 11, including Bankruptcy Code §§ 1122 (classification) and 1129 (confirmation of a plan).

The courts that follow this approach point out that the broad provisions of §§ 1123(a)(5) and (b)(6) are designed to give a plan proponent substantial flexibility in crafting the terms of a plan. These provisions of the Bankruptcy Code sanction creative approaches as opposed to imposing a strait jacket. As the Court put it in *NLRB v. Bildisco & Bildisco*, "the policies of flexibility and equity [are] built into Chapter 11 of the Bankruptcy Code" "[s]ince the policy of Chapter 11 is to permit successful rehabilitation of debtors."[90]

To be clear, there is a contrary view. The *Millennium* district court characterized the argument founded on §§ 1123(a)(5) and (b)(6) as "an adjudicatory 'blank check' " and referred to this argument as "jurisdictional boot strapping."[91] The Millennium district court is not alone. For example, in *In re Digital Impact, Inc.*, the court observed that if a matter over which the Court has no independent jurisdiction can be "metamorphisized into proceedings within the Court's jurisdiction by simply including [a] release in the proposed plan, this court could acquire infinite jurisdiction."[92] Some commentators also argue that an argument founded on § 1123 amounts to boot strapping.[93]

The critics are correct that merely inserting a third-party release in a plan cannot, *in and of itself*, establish "arising under" jurisdiction or confer authority under the substantive provisions of the Bankruptcy Code. Nor can an agreement by a third party to fund a plan, *in and of itself*, establish "arising under" jurisdiction or provide a substantive basis under the

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Bankruptcy Code for confirming such a plan.[94] That would be too cute by half. Nor can general equitable principles, *standing alone*, confer "arising under" jurisdiction or authority to confirm a plan. Not only would this thesis be circular, it would ignore the statutory requirement that the provision be "appropriate" to include in a plan and not violate another provision of the Bankruptcy Code. As Professor Brubaker points out, reliance on "sections such as § 1123(b)(6) merely beg[s] the question whether non-debtor releases are in fact 'appropriate' provisions of a plan" not inconsistent with the applicable provisions of the Bankruptcy Code.[95]

Who is right and who is wrong in that debate goes to the question whether *any* court should confirm a plan that contains a third-party release. At the risk of repetition, let me again underscore that whether a plan containing a third-party release should be confirmed by *any* court is a very different question than whether the Constitution requires that these issues be decided by an Article III district court. And with respect to the constitutional issue—i.e., the subject of this article —the point (on which there should be little disagreement) is that § 1123 and the other sections of chapter 11 discussed below provide a jurisdictional hook for the argument that a third-party release is an "appropriate" provision to include in a plan not inconsistent with any other provision of the Bankruptcy Code.

b. The Factors Evaluated by Pro-Release Courts in Determining Whether it is Appropriate to Include a Third-Party Release in a Plan and Whether the Third-Party Release is Inconsistent with the Applicable Provisions of the Bankruptcy Code

So can pro-release courts found their conclusion that a third-party release is an "appropriate" provision to include in a plan not inconsistent with any other provision of the Bankruptcy Code on the actual provisions of the Bankruptcy Code or, instead, must they rely on loose equitable principles? To answer that question, one must explore the factors evaluated by courts (in circuits other than the Fifth, Ninth and Tenth) in determining whether such a plan can be confirmed.

Pro-release courts have generally endorsed evaluating multiple factors in order to determine whether a reorganization court should confirm a plan containing a third-party release. They are often called the *Master Mortgage* factors since the court in *In re Master Mortgage Inv. Fund*[96] was one of the first to collect the case law and synthesize a list of factors that a court should consider. These factors go by a number of other names—e.g., the *Dow Corning*[97] factors, the *Continental*[98] factors, to list a few—for many courts have concluded that a bankruptcy court should consider certain factors in deciding whether to confirm a plan containing a third-party release. The exact articulation varies, but the basics are the same.

These courts emphasize that these "factors should be considered a non-exclusive list of considerations, and should be applied flexibly."[99] No one factor is dispositive. "No court has set out a rigid 'factor test' to be applied in every circumstance."[100] In combination, an evaluation of these factors requires a very strong showing in order for a reorganization court to confirm a plan containing a third-party release over an objection of a creditor whose claims are being released. "The inquiry is fact intensive in the extreme."[101] Pro-release courts universally state that courts should proceed "cautiously and infrequently" and confirmation of a plan containing a third-party release should be reserved for "unusual cases."[102]

The legal foundation for these factors is twofold.

First, certain of the factors are designed to insure that a plan containing a third-party

release does not violate another provision of the Bankruptcy Code—particularly §§ 1122, 1123(a)(4), 1129(a)(7) and 1129(b)—for a plan that contains a third-party release will almost inevitably raise issues regarding proper classification of claims, equal treatment of creditors in a class, and the best interests test, and will require that the plan be accepted by a class consisting of creditors that hold these third-party claims.

Second, other of the factors evaluated by pro-release courts are designed to test whether the third-party release is a central ingredient of a successful reorganization. They believe this makes sense for, as the Court has observed in numerous cases, reorganization is the paramount purpose of chapter 11[103] and, accordingly, the Court has repeatedly instructed that the provisions of chapter 11 are to be interpreted with greater "flexibility and equity" when that allows a company to reorganize under chapter 11.[104] In sum, "the Supreme Court has repeatedly looked to the policy favoring business reorganization in its decisions interpreting the Bankruptcy Code."[105]

Indeed, the Court made this point in a decision involving a third-party injunction. In *Celotex Corp. v. Edwards,*[106] the Court dealt with a § 105 injunction issued by a bankruptcy court temporarily staying a creditor from pursuing its claims against a non-debtor surety. The Court held that the § 105 injunction could not be attacked collaterally. In order to reach this conclusion, the Court needed to conclude that the bankruptcy court had jurisdiction to issue the § 105 injunction in the first place. The Court quoted the bankruptcy court's conclusion that the stay "may well be the linchpin of Debtor's formulation of a feasible plan"[107] and then observed that "it is relevant to note that we are dealing here with a reorganization under Chapter 11, rather than a liquidation under Chapter 7. The jurisdiction of bankruptcy courts may extend more broadly in the former case than in the later."[108]

In short, the factors considered by pro-release courts are designed to give substance to the requirement that a plan containing a third-party release can be confirmed only if that release is "appropriate" and "not inconsistent with the applicable provisions of the Bankruptcy Code."

These factors include:

(1). Identity of Interests

First, courts consider whether there is an "identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the debtor is, in essence, a suit against the debtor or will deplete the assets of the estate."[109] These courts evaluate whether there is a significant degree of "relatedness" between the claims that are being released and those asserted against the estate.[110] Indeed, in its most recent decision on point, the Second Circuit held that the release of a third party's ability to assert a "direct claim" against a debtor's insurance company for coverage under an insurance policy could be released, but a claim based on separate torts allegedly committed by the insurance company independent of any misconduct by the debtor could not be released even though they were related (in a broad sense) to the debtor.[111] The nexus between claims against the debtor and the claims being released is usually so strong that the third-party claims are viewed as " 'back door' actions which are in reality actions against the debtor."[112]

Indeed, the best interests test of Bankruptcy Code § 1129(a)(7) requires a high degree of "relatedness." Of course, the best interests test needs to be satisfied with respect to any impaired creditor that rejects the plan—even if that creditor is outvoted by others in its class. The best interests test will be satisfied only if the damages that an objecting impaired creditor could recover from the third-party are identical to the damages that this creditor as-

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serts against the debtor in the chapter 11 case. Otherwise, in a hypothetical chapter 7 liquidation, the objecting creditor would be able to assert separate damages against the third-party in an amount different than—and in addition to—its claim against the debtor.[113] Phrased differently, the best interests test requires that the damages asserted be interdependent even if the legal bases of the claims are independent.

Some have asserted that this strong nexus is needed in order to give a bankruptcy court "related to" jurisdiction over the third-party claim.[114] That is unfortunate and conflates two different issues. A bankruptcy court does not exercise "related to" jurisdiction over the third-party claim when it confirms a plan with a release of that claim. Rather, the requirement that the claim being released have a strong degree of "relatedness" to a claim against the third-party debtor is relevant to whether the plan satisfies the best interests test.

As explained in Part II of this article, a high degree of "relatedness" is also relevant in evaluating whether it is constitutional for a non-Article III court to exercise "arising in" or "arising under" jurisdiction (without consent). But, in any event, the jurisdiction is "arising in" or "arising under," not "related to."

(2). The Non-Debtor has Contributed Substantial Assets to the Reorganization

Pro-release courts consider whether the non-debtor contributes substantial assets to the reorganization.[115] That presupposes that the debtor is reorganizing, rather than liquidating, and is consistent with the teachings of the Court that the provisions of the Bankruptcy Code are to be read more expansively when the context is a reorganization. In some of the larger chapter 11 cases, the amounts contributed range into the billions. Whether the contribution is, in fact, substantial is often litigated and a number of pro-release courts have declined to confirm plans after concluding that the contribution failed this test.[116]

(3). The Third-Party Release is Essential/ Important to the Reorganization

The third *Master Mortgage* factor is whether the third-party release is "essential to reorganization." In other words, "[w]ithout . . . it, there is little likelihood of success."[117] Of course, this factor is usually tied to the second —a third-party release is usually essential to the reorganization in the sense that without the release the beneficiary of the release would not make a contribution that in turn is an essential element of a successful reorganization. Pro-release courts sometimes probe as to whether a release that only binds those creditors who consent would suffice or if a release that binds an objecting minority is really needed in order to induce the contribution. In addition, courts sometimes analyze whether a release is limited in scope to what is necessary to induce the contribution.

(4). The Impacted Class of Creditors has Overwhelmingly Voted to Accept the Plan

The fourth *Master Mortgage* factor is whether the "impacted class, or classes, has 'overwhelmingly' voted to accept the proposed plan treatment."[118] In other words, pro-release courts consider whether the plan is strongly supported by most of the creditors who have claims that are being released. Hold-outs are only bound by the will of a substantial majority.

The fourth *Master Mortgage* factor presupposes that creditors who have third-party claims must be classified together in their own class. Separation classification is, in fact, required by Bankruptcy Code §§ 1122(a) and 1123(a)(4).[119] If creditors with third-party claims subject to a proposed release were lumped with creditors without such claims, then the members of that class with the third-party claims would not receive the equal treatment required by § 1123(a)(4). The D.C. Circuit made this point in *In re AOV Indus., Inc*.[120] "It is disparate treatment when members of a

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common class are required to tender more valuable consideration—be it their claim against specific property of the debtor or some other cognizable chose in action—in exchange for the same percentage of recovery. . .. [T]o the extent that the creditor was called upon to release a unique direct [non-debtor] claim in order to participate in the [pro rata distribution], we conclude that the creditor was being subjected to unequal treatment in violation of 11 U.S.C. § 1123(a)(4)."[121]

Similarly, combining creditors with third-party claims that are being released with other creditors who do not have third-party claims would probably violate the requirement of Bankruptcy Code § 1122(a) that only "substantially similar" claims be placed in a single class. Class voting is one of the cornerstones of chapter 11. It operates from the premise that creditors in a properly constituted class are sufficiently similarly situated so that a class vote should bind the minority with respect to the most important elements of plan confirmation. When a plan affects some creditors' rights against third-parties, it would be improper to allow the votes of creditors without third-party claims to carry the class.

These two requirements are interrelated. "[C]lassification and treatment cannot be divorced from one another. Therefore, whether one characterizes the problem as one of improper classification or unequal treatment is, to a large degree, a matter of semantics—merely capturing the same problem in a different way."[122]

If the class of creditors whose third-party claims are to be released rejects the plan by class vote, it is extremely unlikely that a plan could be crammed down on the rejecting class—i.e., it is not likely to be deemed fair and equitable.[123]

Thus, at a minimum, Bankruptcy Code § 1126(c) requires that at least 2/3 in amount and more than 50% in number of the creditors with third-party claims who vote accept the plan. That is the minimum requirement. The pro-release courts that follow the *Master Mortgage* factors consider whether that vote was stronger still —was it "overwhelming."[124]

As a result, a creditor who contends that its third-party claims cannot be released by a chapter 11 plan has been outvoted—probably by an overwhelming margin—by other creditors with the same rights and same third-party claims. In other words, the plan opponent is a hold-out. One of the overarching policies reflected in chapter 11 is that most confirmation issues are to be decided by class vote of similarly situated creditors; it is a collective process. This requirement that a plan be accepted by a class of creditors with third-party claims bolsters the argument that such a plan is appropriate under the substantive provisions of chapter 11 and also has implications as to whether it is constitutional for a non-Article III bankruptcy court to confirm a plan—the topic to be addressed in Part II next month.

(5). The Plan Provides a Mechanism for the Payment of All, or Substantially All, of the Claims of the Class (or Classes) Affected by the Third-Party Release

The fifth *Master Mortgage* factor considers whether the plan provides for distributions that will satisfy the affected creditors in full, or substantially in full.[125]

In most situations, this will be required by the best interests test of Bankruptcy Code § 1129(a)(7)(A).[126] The best interests test requires that any impaired creditor that does not accept the plan "receive or retain under the plan on account of such claim . . . property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date." When a plan does not

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contain a third-party release, the plan does not affect what an objecting creditor might recover from a third party and, as a result, third party claims need not be considered in the best interests calculus. But if a plan contains a third-party release, there is a strong argument that the best interests test requires consideration of what the creditor could recover from the third party if the debtor liquidated. If the debtor were liquidated under chapter 7, there would be no third-party release (for, among other reasons, the release could not be essential to a reorganization since the debtor is not reorganizing) and the dissenting creditor could pursue the non-debtor obligor. So the best interests test arguably requires a comparison of (i) the dissenting creditor's distribution in the plan with no prospect of receiving anything from the non-debtor obligor, and (ii) what the dissenting creditor would receive in a chapter 7 liquidation of the debtor coupled with the ability to pursue the non-debtor obligor.

If the non-debtor obligor is solvent and the claim against the non-debtor is valid, this equates to a requirement that the creditor receive a 100% distribution. This presumably will be the normal situation and is what is contemplated by the fifth *Master Mortgage* factor.

If the non-debtor is not solvent *or* if the non-debtor has defenses against the claim, then the best interests test may not require payment in full.[127] This second qualifier can be important. Non-debtor released parties often face credible causes of action asserted by the *estate* and substantially less strong direct claims asserted by creditors. From the perspective of the released party, these non-debtor claims are the result of creative pleading (or liberal standards for co-liability) on claims that are "in reality claims against the debtor."[128] While the defendant might well prevail in that litigation, it may not be willing to settle with the estate if it has to continue to litigate with a hold-out. Or at a minimum, what it will be willing to contribute to the reorganization will be reduced by the costs and risks of needing to defend litigation brought by a hold-out. Some courts have captured this concept by rephrasing the fifth *Master Mortgage* test to be whether the benefits of the third-party's contribution are "fair consideration" for the claims released.[129] Sometimes creditors who assert that they have third-party claims being released can only offer vague articulations of third-party claims or the claims that they articulate are subject to substantial uncertainty; in those situations, some courts have concluded that the plan can be confirmed notwithstanding the fact that the creditor will receive less than payment substantially in full.[130]

In addition, the best interests test arguably requires that the damages asserted by a dissenting creditor against the debtor and the third party be identical even if the causes of action are distinct. If these damages are not co-extensive, the complaining creditor would have a strong argument that the best interests test requires that this creditor receive the additional damages it could recover from the third party on top off whatever it gets in the bankruptcy case. So even if the creditor receives a full recovery of its claims against the debtor—i.e., a 100% distribution in the chapter 11 case—the objecting creditor could contend that the best interests test would not be satisfied if a third-party release cut off the creditor's ability to get even more from the third party. As described above, this aspect of the best interests test is closely tied to the requirement that there be an identity between the creditor's claims against the debtor and the third party.

Conclusion (Part I)

Courts in the circuits that follow the majority view must take as a given that the Bankruptcy Code authorizes confirmation of a plan containing a third-party release if certain tests

are met. There are strong contrary arguments, but they go to whether any court can confirm such a plan. Moreover, they are the minority view.

If one accepts (as must courts in a majority of the circuits) the premise that a plan containing a third-party release may be confirmed if certain tests are met, the constitutional question is whether a district court must decide whether the plan in question passes muster.

If one perceives the court as exercising "related to" jurisdiction over third-party claims, the district court must decide whether to confirm the plan. But that operates off of a false premise, for the exercise of "related to" jurisdiction over the claims being released would not provide a substantive basis to release these claims. Moreover, it is not what is going on when a court analyzes whether a plan comports with the requirements of the Bankruptcy Code.

Confirmation of a chapter 11 plan providing for the nonconsensual release of third-party claims can be justified (if at all) only based on the substantive provisions of the Bankruptcy Code, including §§ 1122, 1123, 1126, and 1129. Determining whether a plan satisfies those standards is an exercise of "arising in" and/or "arising under" jurisdiction.

Part II of this article, to be published in the *Bankruptcy Law Letter* next month, will address why it is constitutional for a non-Article III bankruptcy court to decide these questions.

ENDNOTES:

[1]Const. Art. III, § 1.

[2]Northern Pipeline Const. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 102 S. Ct. 2858, 73 L. Ed. 2d 598, 6 Collier Bankr. Cas. 2d (MB) 785, Bankr. L. Rep. (CCH) P 68698 (1982) (hereinafter, "Marathon").

[3]Wellness Intern. Network, Ltd. v. Sharif, 135 S. Ct. 1932, 1938-1939, 191 L. Ed. 2d 911, 61 Bankr. Ct. Dec. (CRR) 32, 73 C.B.C. 1575, Bankr. L. Rep. (CCH) P 82806 (2015).

[4]In re Millennium Lab Holdings II, LLC, et al., Bankr. D. Del., Case No. 15-12284 (LSS), Doc. Item No. 476, October 3, 2017 (hereinafter the "Millennium Bankruptcy Court Decision").

[5]The terminology "third-party release" can mean different things in different contexts. By "third-party release" I mean a provision in a plan of reorganization that releases claims asserted by a creditor against a non-debtor defendant.

Plans and settlements often provide for the release by a bankruptcy estate of claims it has against third parties. Such releases are sometimes referred to as "third-party releases." But that is not how I use the terminology "third-party release" in this article. The release of claims held by the estate presents a different (and simpler) set of issues than the release of claims that a non-debtor has against another non-debtor.

In addition, plans often contain a broadly worded release of any claims that might be asserted against the participants in the bankruptcy case based on their actions during the case. That sort of exculpation also presents simpler jurisdictional and constitutional issues and is not what I mean by a "third-party release."

Provisions typically found in bankruptcy court orders authorizing the sale of estate assets free and clear of claims, including claims based on successor liability, are also sometimes thought of as "third-party releases." But they also are not covered by this article.

In addition, channeling injunctions—injunctions that channel resolution of third-party claims to a trust—present a unique set of issues that are beyond the scope of this article.

Finally, let me be clear that this article only addresses nonconsensual third-party releases. If a creditor opposes a plan on the grounds that the plan cannot release claims that the objector has against third parties, by definition the release is not consensual.

[6]See, e.g., Benjamin Feder, "Judge Silverstein's Opinion in Millennium Lab Holdings Threatens to Bring Clarity and Common Sense to Debate Regarding Constitutional Power of Bankruptcy Courts," Kelly, Drye & Warren LLP Bankruptcy Insights Blog, November 6, 2017, available at https://www.lexology.com/library/detail.aspx?g=db64ee77-0735-4009-a539-

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512b4f4c75aa; Paul, Weiss, Rifkind, Wharton & Garrison LLP, “Delaware Bankruptcy Court Affirms Its Constitutional Authority to Approve Nonconsensual Releases,” October 19, 2017, available at https://www.lexology.com/library/detail.aspx?g=ef82fc10-4f0e-4cce-a56e-22fd12b43437; Dechert LLP, “Millennium Lab Part II: Delaware Bankruptcy Court Dispels Shadow Over Non-Consensual Third-Party Releases (For Now),” October 24, 2017, available at https://www.lexology.com/library/detail.aspx?g=538eo303-7b01-4c17-80b6-7e9c094fca44; David Bass and Mark Tsukerman, “Bankruptcy Court Jurisdiction and Third-Party Releases: The Latest Frontier,” N.Y.L.J. June 14, 2017, available at http://newyorklawjournal.com/printerfriendly/id=1202789850900; Matt Chiappardi, “Millennium Labs Case May Doom Powerful Ch. 11 Tool,” June 20, 2017, available at https://www.law360.com/bankruptcy/articles/93605; Kramer Levin Naftalis & Frankel LLP, “A New Millennium: Bankruptcy Courts May Lack Constitutional Authority to Approve Nonconsensual Plan Releases,” July 31, 2017, available at https://www.lexology.com/library/detail.aspx?g=88b5545c-8197_4f9b-bc80-0a7c0222.

[7]In the bankruptcy context, the distinction between “subject matter jurisdiction” and “authority” is a fine one. If the Bankruptcy Code provides that a court can confirm a plan that meets certain standards, one might say that the court has subject matter jurisdiction to decide these issues but no authority to confirm a plan that is inconsistent with these substantive requirements. Nonetheless, courts sometimes say that a bankruptcy court lacks subject matter jurisdiction to approve a matter that is not authorized by the Bankruptcy Code. Given the breadth of “related to” jurisdiction, a bankruptcy court will almost always have subject matter jurisdiction—unless the issues are very far afield from the bankruptcy case. So in the bankruptcy context, the terms “subject matter jurisdiction” and “authority” are sometimes used interchangeably. While I have tried to be careful, the distinction is a fine one and those who like to pick nits may find places where they believe I used the wrong terminology.

[8]Ralph Brubaker, “Nondebtor Releases and Injunctions in Chapter 11: Revisiting Jurisdictional Precepts and the Forgotten Callaway v. Benton Case,” 72 Am. Bankr. Law J. 1 (1998) (hereinafter, “Revisiting Jurisdictional Precepts”); Ralph Brubaker, “Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations,” 1997 U. Ill. L. Rev. 959 (1997) (hereinafter, “A Critical Reappraisal”).

[9]In re Pacific Lumber Co., 584 F.3d 229, 252-253, 52 Bankr. Ct. Dec. (CRR) 46, Bankr. L. Rep. (CCH) P 81642 (5th Cir. 2009); In re Lowenschuss, 67 F.3d 1394, 1401-1402, 34 Collier Bankr. Cas. 2d (MB) 544, Bankr. L. Rep. (CCH) P 76673, 33 Fed. R. Serv. 3d 249 (9th Cir. 1995); In re Western Real Estate Fund, Inc., 922 F.2d 592, 600-602, 21 Bankr. Ct. Dec. (CRR) 320, 24 Collier Bankr. Cas. 2d (MB) 1012, Bankr. L. Rep. (CCH) P 73754 (10th Cir. 1990), opinion modified, 932 F.2d 898 (10th Cir. 1991); In re American Hardwoods, Inc., 885 F.2d 621, 624-626, 19 Bankr. Ct. Dec. (CRR) 1354, Bankr. L. Rep. (CCH) P 73130 (9th Cir. 1989); Underhill v. Royal, 769 F.2d 1426, 1432, 13 Collier Bankr. Cas. 2d (MB) 1198, Bankr. L. Rep. (CCH) P 70718, Fed. Sec. L. Rep. (CCH) P 92280 (9th Cir. 1985) (rejected on other grounds by, Reves v. Ernst & Young, 494 U.S. 56, 110 S. Ct. 945, 108 L. Ed. 2d 47, Blue Sky L. Rep. (CCH) P 73213, Fed. Sec. L. Rep. (CCH) P 94939 (1990)).

[10]In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070, 1077-1079, 60 Bankr. Ct. Dec. (CRR) 212, 73 Collier Bankr. Cas. 2d (MB) 605, Bankr. L. Rep. (CCH) P 82783 (11th Cir. 2015), cert. denied, 136 S. Ct. 109, 193 L. Ed. 2d 37 (2015); In re Airadigm Communications, Inc., 519 F.3d 640, 655-658, 49 Bankr. Ct. Dec. (CRR) 179, Bankr. L. Rep. (CCH) P 81123 (7th Cir. 2008); In re Metromedia Fiber Network, Inc., 416 F.3d 136, 44 Bankr. Ct. Dec. (CRR) 276, 54 Collier Bankr. Cas. 2d (MB) 1033, Bankr. L. Rep. (CCH) P 80397 (2d Cir. 2005); In re Dow Corning Corp., 280 F.3d 648, 655-658, 39 Bankr. Ct. Dec. (CRR) 9, 47 Collier Bankr. Cas. 2d (MB) 1158, Bankr. L. Rep. (CCH) P 78582, 2002 FED App. 0043P (6th Cir. 2002); Matter of Munford, Inc., 97 F.3d 449, 29 Bankr. Ct. Dec. (CRR) 1087, 36 Collier Bankr. Cas. 2d (MB) 1604, 35 Fed. R. Serv. 3d 1538 (11th Cir. 1996); Monarch Life Ins. Co. v. Ropes & Gray, 65 F.3d 973, 984-985, 27 Bankr. Ct. Dec. (CRR) 1039, 34 Collier Bankr. Cas. 2d (MB) 313, Bankr. L. Rep. (CCH) P 76634 (1st Cir. 1995); In re Drexel Burnham Lambert Group, Inc., 960 F.2d 285, 26 Collier Bankr. Cas. 2d (MB) 1413, 22 Fed. R. Serv. 3d 1091 (2d Cir. 1992); In re AOV Industries, Inc., 792 F.2d 1140, 14 Bankr. Ct. Dec. (CRR) 816, Bankr. L. Rep. (CCH) P 71190 (D.C. Cir. 1986); In re A.H. Robins Co., Inc., 880 F.2d 694, 19

Bankr. Ct. Dec. (CRR) 997, Bankr. L. Rep. (CCH) P 72955 (4th Cir. 1989); and MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89, 17 Bankr. Ct. Dec. (CRR) 293, 18 Collier Bankr. Cas. 2d (MB) 316, Bankr. L. Rep. (CCH) P 72180 (2d Cir. 1988). The Third Circuit's decisions are discussed in note 12 infra. The Eighth Circuit Court of Appeals has not addressed this issue. But some lower courts in the Eighth Circuit have endorsed the majority view, including in one of the most often cited decisions for the factors that a court that follows the majority view should consider in analyzing whether to confirm a plan that contains a third-party release. In re Master Mortg. Inv. Fund, Inc., 168 B.R. 930, 31 Collier Bankr. Cas. 2d (MB) 240 (Bankr. W.D. Mo. 1994).

[11]Millennium Bankruptcy Court Decision, supra note 4 at 2.

[12]Judge Silverstein set forth her analysis of Third Circuit law in a January 12, 2016 order certifying this question to the Third Circuit. In re Millennium Lab Holdings II, LLC, 543 B.R. 703, 62 Bankr. Ct. Dec. (CRR) 19 (Bankr. D. Del. 2016) (hereinafter, the "Millennium Certification Order"). As she pointed out, in In re Continental Airlines, 203 F.3d 203, 35 Bankr. Ct. Dec. (CRR) 176 (3d Cir. 2000) (hereinafter, "Continental Airlines"), the Third Circuit considered an appeal from a bankruptcy court order confirming a plan that contained a third-party release. The Third Circuit's opinion identified the "hallmarks of permissible non-consensual releases—fairness, necessity to the reorganization, and specific factual findings to support these conclusions." 203 F.3d at 214. This statement has generally been interpreted (both within and outside the Third Circuit) to mean that the Third is among the Circuits where controlling law provides that the Bankruptcy Code authorizes confirmation of a plan containing a third-party release if certain tests are met. But this oft-quoted passage in Continental Airlines is dicta, for based on the facts before it, the Third Circuit concluded that the specific plan at issue "does not pass muster under even the most flexible tests for the validity of non-debtor releases," overturned the confirmation order on that grounds, and declined to "establish our own rule regarding the conditions under which non-debtor releases and permanent injunctions are appropriate or permissible." Id. Many have interpreted these statements to mean that the Third Circuit accepted the base point that the Bankruptcy Code allows a plan to include a third-party release if certain tests are met but left the contours of those tests to future decisions. In the Millennium Certification Order, Judge Silverstein explained why she concluded that this is the correct interpretation of Continental Airlines. Millennium Certification Order, 543 B.R. at 711-715. She pointed out that since Continental Airlines, the Third Circuit has twice stated that a plan containing a third-party release may be confirmed if certain tests are met. Id. at 711 (discussing United Artists Theatre Co. v. Walton, 315 F.3d 217, 227, 40 Bankr. Ct. Dec. (CRR) 182, 49 Collier Bankr. Cas. 2d (MB) 1434, Bankr. L. Rep. (CCH) P 78777 (3d Cir. 2003); and In re Global Indus. Technologies, Inc., 645 F.3d 201, 206, 54 Bankr. Ct. Dec. (CRR) 178, Bankr. L. Rep. (CCH) P 81998, 87 A.L.R. Fed. 2d 691 (3d Cir. 2011)). She also surveyed lower court decisions in the Third Circuit which generally, but not universally, conclude that controlling Third Circuit law provides that a chapter 11 plan can contain a nonconsensual third-party release. Millennium Certification Order, 543 B.R. at 713-715. While Judge Silverstein concluded that controlling Third Circuit law provides that a plan containing a nonconsensual third-party release can be confirmed, she certified this question to the Third Circuit. Id. at 715-717. The Third Circuit declined to accept that certification.

[13]See, e.g., Stoll v. Gottlieb, 305 U.S. 165, 59 S. Ct. 134, 83 L. Ed. 104 (1938). Stoll v. Gottlieb is famous for its holding that a final order of a bankruptcy court confirming a bankruptcy plan may not be attacked collaterally. It is less well remembered for the fact that the issue at hand was a nonconsensual third-party release.

[14]Continental Airlines, supra note 12, 203 F.3d at n. 12 ("We also note, with some concern, that the Bankruptcy Court apparently never examined its jurisdiction to release and permanently enjoin Plaintiffs' claims against non-debtors. Although bankruptcy subject matter jurisdiction can extend to matters between non-debtor third-parties affecting the debtor or the bankruptcy case [citations omitted], a court cannot simply presume it has jurisdiction in a bankruptcy case to permanently enjoin third-party class actions against non-debtors. We must remain mindful that bankruptcy jurisdiction is limited, as is the explicit grant of authority to bankruptcy courts. [Citing the Judicial Code and Marathon]. We do not treat this very significant issue more fully,

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however, because the record does not permit us to resolve this issue and the parties have not raised and discussed it in their appellate briefs.").

[15]Opt-Out Lenders v. Millennium Lab Holdings II, LLC, et al., TA Millennium, Inc. and James Slattery (In re Millennium Lab Holdings II, LLC), D. Del. Civ. No. 16-110-LPS, Memorandum Opinion, Doc. Item No. 48, March 20, 2017 (hereinafter, the "Millennium District Court Remand").

[16]Id.

[17]Id. at 8-9.

[18]Supplemental Brief of the Debtors, TA Millennium, Inc., and James Slattery Regarding the Court's Adjudicatory Authority and Related Issues on Remand From the District Court, May 19, 2017, filed in In re Millennium Lab Holdings II, LLC, et al, Bankr. Case No. 15-12284 (LSS) (Bankr. D. Del.), Doc. Item No. 437 (hereinafter, the "Millennium Debtors' Remand Brief") at 3-4.

[19]Millennium Certification Order, supra note 12, 543 B.R. at 705.

[20]Millennium Debtors' Remand Brief, supra note 18 at 4; Millennium District Court Remand, supra note 15 at 9.

[21]The claims released included fraudulent conveyance claims related to $1.3 billion of dividends Millennium's equity holders had received in April 2014 financed by the $1.825 billion of senior secured debt. The loans made in April 2014 "were primarily used to pay off certain existing debt and provide a special dividend to equity holders as well as to provide for working capital." Millennium Certification Order, supra note 12, 543 B.R. at 705. The estate's release of its fraudulent conveyance claims related to this dividend recapitalization was not challenged on appeal.

[22]Id.

[23]Millennium District Court Remand, supra note 15 at 9.

[24]Millennium Debtors' Remand Brief, supra note 18 at 4.

[25]Millennium District Court Remand, supra note 15 at 7.

[26]Millennium Debtors' Remand Brief, supra note 18 at 4.

[27]ISL Loan Trust v. TA Associates Management, L.P., et al., Civ. No 15-1138 (GMS) (D. Del.).

[28]Stern v. Marshall, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475, 55 Bankr. Ct. Dec. (CRR) 1, 65 Collier Bankr. Cas. 2d (MB) 827, Bankr. L. Rep. (CCH) P 82032 (2011).

[29]Millennium Certification Order, supra note 12, 543 B.R. at 707; Millennium Bankruptcy Court Decision, supra note 4 at 6-7. Voya's remaining five issues on appeal dealt with whether a plan containing a third-party release can be confirmed (and, if so, on what terms).

[30]The district court observed that the "Bankruptcy Court held that it had, at a minimum, 'related to' subject matter jurisdiction under Pacor. . . The Bankruptcy Court further held that Stern v. Marshall does not change the conclusion that this Bankruptcy Court has **jurisdiction**." The district court observed simply that "[t]his Court agrees." Millennium District Court Remand, supra note 15 at 24 (emphasis in original).

[31]Millennium District Court Remand, supra note 15 at 27-28.

[32]Millennium Bankruptcy Court Decision, supra note 4 at 53-69. Voya disputes the conclusions that it consented to the bankruptcy court exercising jurisdiction and/or forfeited the ability to raise the constitutional argument. Whether or not Voya actually consented to bankruptcy court jurisdiction or forfeited the constitutional argument are beyond the scope of this article. But if factually sound, these alternative holdings have support in the Court's most recent Article III decision. In Wellness International Network, Ltd. v. Sharif, supra note 3, the Court held that even when Congress cannot delegate full-decision-making authority to a bankruptcy court, "Article III is not violated when the parties knowingly and voluntarily consent to adjudication by a bankruptcy judge." 135 S. Ct. at 1939. In its remand instructions in Wellness, the Court observed that an Article III objection can also be "forfeited" by failing to raise it timely below. 135 S. Ct. at 1949. So in Wellness, the Court remanded to the Seventh Circuit for a determination as to whether the debtor knowingly and voluntarily consented or whether he had forfeited the ability to make this argument. Id. On remand, the Seventh Circuit held that the debtor had forfeited his ability to raise the Article III issue by failing to raise it timely. Accordingly, the Seventh Circuit did not need to, and did not, decide whether Mr. Sharif had knowingly and voluntarily consented to the

bankruptcy court exercising jurisdiction. Wellness Intern. Network, Ltd. v. Sharif, 617 Fed. Appx. 589 (7th Cir. 2015).

[33]"The 'case' referred to in section 1334(a) is the umbrella under which all of the proceedings that follow the filing of a bankruptcy petition take place." 1 Collier on Bankruptcy ¶ 3.01[2] (16th ed., 2017, Alan N. Resnick and Henry J. Sommer, eds.). But that does not mean that a federal court that exercises bankruptcy jurisdiction has exclusive jurisdiction of all proceedings that occur under that umbrella. Jurisdiction over those proceedings is governed by 28 U.S.C. § 1334(b), which provides for original, but not exclusive, federal bankruptcy jurisdiction over civil proceedings "arising under" the Bankruptcy Code, "arising in" a bankruptcy case, or "related to" a bankruptcy case. Id.

[34]Gupta v. Quincy Medical Center, 858 F.3d 657, 662, 64 Bankr. Ct. Dec. (CRR) 41, 77 Collier Bankr. Cas. 2d (MB) 1576, 2017 I.E.R. Cas. (BNA) 186361, Bankr. L. Rep. (CCH) P 83111 (1st Cir. 2017). See also, Stoe v. Flaherty, 436 F.3d 209, 217, 45 Bankr. Ct. Dec. (CRR) 265, 55 Collier Bankr. Cas. 2d (MB) 724, 11 Wage & Hour Cas. 2d (BNA) 229 (3d Cir. 2006), as amended, (Mar. 17, 2006) (noting that "arising under" jurisdiction is limited to proceedings where "the Bankruptcy Code creates the cause of action or provides the substantive right invoked"): Matter of Wood, 825 F.2d 90, 96, 17 Collier Bankr. Cas. 2d (MB) 743, Bankr. L. Rep. (CCH) P 71955 (5th Cir. 1987)) ("Congress used the phrase 'arising under title 11' to describe those proceedings that involve a cause of action created or determined by a statutory provision of title 11.' ").

[35]1 Collier on Bankruptcy ¶ 3.01[3][c][i] at 3-14 to 3-15 (16th ed. 2017, Alan N. Resnick and Henry J. Sommer, eds.).

[36]Gupta v. Quincy, supra note 34, 436 F.3d at 662-663 (quoting In re Middlesex Power Equipment & Marine, Inc., 292 F.3d 61, 68, 39 Bankr. Ct. Dec. (CRR) 196, 48 Collier Bankr. Cas. 2d (MB) 508, Bankr. L. Rep. (CCH) P 78684 (1st Cir. 2002).

[37]Stoe v. Glaherty, supra note 34, 436 F.3d at 218. See also, 1 Collier on Bankruptcy ¶ 3.01[3][e][iv] at 3-22 to 3-23 (16th ed., 2017, Alan N. Resnick and Henry J. Sommer, eds.).

[38]Stern v. Marshall, 564 U.S. 462, 476, 131 S. Ct. 2594, 180 L. Ed. 2d 475, 55 Bankr. Ct. Dec. (CRR) 1, 65 Collier Bankr. Cas. 2d (MB) 827, Bankr. L. Rep. (CCH) P 82032 (2011), the Court began by grappling with how to interpret 28 U.S.C.A. § 157. The Court held that 28 U.S.C.A. § 157(b)'s grant of authority to enter a final decision (without consent) was restricted to matters that "arise in" a case under title 11 or "arise under" title 11. Id. at 476 ("Under our reading of the statute, core proceedings are those that arise in a bankruptcy case or under title 11.") The Court rejected the contrary argument that 28 U.S.C.A. § 157 should be interpreted to mean that a matter that is designated as statutorily core can be founded on "related to" jurisdiction. Id. at 477 ("It does not make sense to describe a 'core' bankruptcy proceeding as merely 'related to' the bankruptcy case; oxymoron is not a typical feature of congressional drafting.") As a result, if jurisdiction is only "related to," the provisions of 28 U.S.C. § 157(b)(1) are inapplicable. When jurisdiction is "related to," 28 U.S.C.A. § 157(c) governs and requires that (absent consent) a bankruptcy court submit proposed findings of fact and conclusions of law to a district court (sitting as a court of bankruptcy.).

The Court returned to this issue of statutory interpretation in Executive Benefits Ins. Agency v. Arkison, 134 S. Ct. 2165, 189 L. Ed. 2d 83, 59 Bankr. Ct. Dec. (CRR) 160, 71 Collier Bankr. Cas. 2d (MB) 875, Bankr. L. Rep. (CCH) P 82642 (2014). The Court observed that if a claim is only "related to" a bankruptcy case, then the "bankruptcy court simply teats the claim[a] as non-core: The bankruptcy court should hear the proceeding and submit proposed findings of fact and conclusions of law to the district court for de novo review and entry of judgment." Id. at 2173. In Arkison, the Court closed the so-called statutory gap created by Stern by holding that the grant of authority to bankruptcy courts in 28 U.S.C.A. § 157(b) to issue final decisions in the matters that the statute listed as "core" included the lesser power to issue proposed findings and conclusions set forth in 28 U.S.C.A. § 157(c)(1). Accordingly, when the Court determined that the statutory grant to issue a final decision in a statutorily core matter was unconstitutional, the severability provision contained in the legislation meant that the lesser constitutional grant to issue proposed findings and conclusions remained and was operative. Id. at 2173. But the Court did not suggest (and severability principles would not support) rewriting 28 U.S.C.A. § 157(b) to expand the matters over which Congress authorized bankruptcy courts to issue final decisions to include "related to" proceedings. Rather, if a "claim is 'related to a

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case under title 11' under any plausible construction of the statutory text, and no party contends otherwise," a bankruptcy court is to "follow the procedures required by [28 U.S.C.A. § 157(c)(1)]. . ., i.e., to submit proposed findings of fact and conclusions of law to the District Court to be reviewed de novo." Id. at 2174. So until and unless Congress acts, the statute probably only authorizes bankruptcy courts to issue final decisions (absent consent) in proceedings founded on "arising under" and "arising in" jurisdiction.

In her October 3, 2017 decision in Millennium, Judge Silverstein accepted the premise that if jurisdiction is "related to," 28 U.S.C.A. § 157 requires that she must submit proposed findings of fact and conclusions of law to the district court (absent consent). Millennium Bankruptcy Court Decision, supra note 4 at 11.

[39]Ralph Brubaker, "Non-Article III Adjudication: Bankruptcy and Nonbankruptcy, with and without Litigant Consent," 33 Emory Bankr. Dev. J. 11, 40 (2016) (hereinafter, "Non-Article III Adjudication").

[40]Id. The exception to which Professor Brubaker refers is for "personal injury tort and wrongful death claims against the estate." 28 U.S.C.A. § 157 (b)(2)(B) excludes these claims from the definition of "core" matters and § 157(b)(5) provides that these claims are to be "tried in the district court in which the bankruptcy case is pending, or in the district in which the claim arose."

[41]This should directly follow from Marathon, supra note 2. The Bankruptcy Reform Act of 1978 had substantially expanded the scope of bankruptcy jurisdiction afforded to bankruptcy court—whether it be a district court sitting in bankruptcy or a non-Article III bankruptcy court—to include all matters "related to cases under title 11." It was an aspect of that broad grant of "related to" jurisdiction that Marathon held was constitutionally improper. 458 U.S. at 76 ("Art. III bars Congress from establishing legislative courts to exercise jurisdiction over all matters related to those arising under the bankruptcy laws.") See also, 458 U.S. at 74-75. The reasons why it would be impermissible for Congress to grant "related to" jurisdiction to a non-bankruptcy court to enter a final decision (without consent) on the merits of a third-party claim are explored further in Part II of this article.

[42]Celotex Corp. v. Edwards, 514 U.S. 300, 307 n.5, 115 S. Ct. 1493, 131 L. Ed. 2d 403, 27 Bankr. Ct. Dec. (CRR) 93, 32 Collier Bankr. Cas. 2d (MB) 685, Bankr. L. Rep. (CCH) P 76456, 31 Fed. R. Serv. 3d 355 (1995).

[43]In re Munford, Inc., supra note 10, 97 F.3d at 453. Many courts have endorsed the articulation of "related to" jurisdiction set forth by the Third Circuit in Pacor, Inc. v. Higgins, 743 F.2d 984, 12 Bankr. Ct. Dec. (CRR) 285, Bankr. L. Rep. (CCH) P 70002 (3d Cir. 1984). "The usual articulation of the test for determining whether a civil proceeding is related to bankruptcy is whether *the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy*." Id. at 994 (emphasis in original). This definition of "related to" jurisdiction is broad. And Professor Brubaker has argued (persuasively and extensively) that the proper scope of "related to" jurisdiction is even broader than the Pacor test. Ralph Brubaker, "On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory," 41 William & Mary L. Rev. 743 (2000).

[44]This is the first prong of the oft-cited Master Mortgage test. In re Master Mortgage Investment Fund, Inc., supra note 10, 168 B.R. at 934-35. Courts that allow nonconsensual third-party releases almost uniformly require a significant degree of "relatedness" between the claims being released and those asserted against the estate. See, e.g., In re Dow Corning Corp., supra note 10, 280 F.3d at 658 ("There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate. . ."); In re Seaside Engineering & Surveying, Inc., supra note 10, 780 F. 3d at 1079-1080; In re Monarch Life Insurance Co., supra note 10, 65 F.3d at 980; In re Airadigm Communications, Inc., supra note 10, 519 F.3d at 657; In re Charles Street African Methodist Episcopal Church of Boston, 499 B.R. 66, 83-84 (Bankr. D. Mass. 2013).

[45]As the district court explained, the "Bankruptcy Court did not conduct any proceedings on the merits of the Fraud Action, and this Court is not in any position at this point to adjudicate those claims (on which, among other things, no discovery has been taken)." Millennium District Court Remand, supra note 15 at 27.

[46]Stoll v. Gottlieb, 305 U.S. 165, 59 S. Ct.

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134, 83 L. Ed. 104 (1938).

[47]The bankruptcy court was a district court exercising bankruptcy jurisdiction. Stoll v. Gottlieb dealt with a corporate reorganization under § 77B of the Bankruptcy Act of 1898. During the four years it was in effect (1934-1938), § 77B governed corporate reorganizations. The bankruptcy court in Stoll v. Gottlieb was a district court sitting in bankruptcy because "§ 77B(c)(1) only authorized references to special masters, who were often referees, but who had only the power to hear and report rather than determine." 6 Collier on Bankruptcy ¶ 3.35[1] at 681 (14th ed., 1978, James William Moore and Lawrence P. King, eds.). So the district court, sitting as a bankruptcy court, confirmed the plan including the third-party release. Gottlieb v. Crowe, 368 Ill. 88, 89, 12 N.E.2d 881 (1937). The fact that the bankruptcy court in Stoll v. Gottlieb was an Article III court is interesting but irrelevant to the current point—issue preclusion applies to an order confirming a plan containing a third-party release even though the court did not exercise "related to" jurisdiction to determine the merits of the third-party claim.

[48]Stoll, 305 U.S. at 169 (emphasis supplied).

[49]Brubaker, "Revisiting Jurisdiction Precepts," supra note 8, 72 Am. Bankr. L.J. at 30 ("as a general matter, the courts concluded that there was no bankruptcy jurisdiction whatsoever, neither summary nor plenary, to decide disputes between two nondebtors, even if the cause of action arose out of the parties' relationship with the debtor."). The situation changed radically in 1978 when Congress conferred "related to" jurisdiction on courts presiding over bankruptcy cases. Id. at 33.

[50]As mentioned earlier, the court could not have exercised "related to" jurisdiction over the third-party claim since there was no such concept under the 1898 Act.

[51]Stoll, 305 U.S. at 177.

[52]To use the Court's language in Stoll v. Gottlieb.

[53]This is why in Stoll v. Gottlieb the state court properly took jurisdiction over the claim on the guarantee (and was the first court to do so) but was required to give preclusive effect to the bankruptcy court's cancellation of the guarantee. So too the district court where Voya filed its litigation has jurisdiction over the common law fraud and RICO claims asserted by Voya. That district court should give preclusive effect to the release if/when Judge Silverstein's bankruptcy law decision becomes final.

[54]Millennium Bankruptcy Court Decision, supra note 4 at 34-50.

[55]In re AOV Industries, Inc., 792 F.2d 1140, 14 Bankr. Ct. Dec. (CRR) 816, Bankr. L. Rep. (CCH) P 71190 (D.C. Cir. 1986).

[56]The objectors argued that the third-party release in the plan required the bankruptcy court to exercise jurisdiction over a "related proceeding"—i.e., the third-party claim. Id. at 1145.

[57]Id. at 1145.

[58]Id. at 1145-1146. When the court turned to whether the plan passed muster under the Bankruptcy Code, it concluded that it did not because creditors with third-party claims were classified together with creditors without third-party claims and, as a result, the plan violated the requirement of Bankruptcy Code § 1123(a)(4) that all members of a class receive equal treatment. This aspect of AOV is discussed infra at notes 120-121 and accompanying text and illustrates that the substantive provisions of chapter 11 may preclude confirmation of a chapter 11 plan containing a third-party release. The key point for present purposes is that these are bankruptcy law issues and the jurisdiction is "arising under" or "arising in" rather than "related to" jurisdiction over the third-party claim.

[59]In re Charles Street African Methodist Episcopal Church of Boston, 499 B.R. 66 (Bankr. D. Mass. 2013).

[60]Id. at 81. "Similarly, when a bankruptcy court approves a sale of estate property free and enjoins the assertion of third-party successor liability claims against the purchaser, it is not 'resolv[ing] the merits of the common law claims but rather . . . enforce[ing] its own order in an action that stemmed from the bankruptcy sale. The bankruptcy court properly issued its own order in an action that stemmed from the bankruptcy sale.' In re Christ Hospital, 2014 WL 4613316 *10 (D. N.J. 2014).' "

[61]See sections III.B.3.b(1) and (3) infra.

[62]1 Collier on Bankruptcy ¶ 3.01[3][e][ii] at 3-16 to 3-21 (16th ed., 2017, Alan N. Resnick and Henry J. Sommer, eds.).

[63]At the outset of this article, I mentioned that it would not cover channeling injunctions for they involve a host of other issues not pre-

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sent with a "garden variety" third-party release. Note 5 supra. One of those differences is that a channeling injunction might well require the exercise of "related to" jurisdiction over the claims that are channeled (perhaps in combination with "arising in" and/or "arising under" jurisdiction). A typical channeling injunction provides that claims asserted by creditors against non-debtors —usually an insurance company but sometimes an affiliate— are channeled to a trust, with a mechanism (often streamlined) to determine the merits of those third-party claims and make payments on them. So unlike the sort of plan containing a third-party release discussed here, a plan with a channeling injunction does purport to decide the merits of the third-party claims and establish a mechanism for making distributions on those third-party claims. The claims that are channeled are often personal injury and tort claims, which 28 U.S.C.A. § 157 (b)(5) requires be tried in the district court. In addition, Bankruptcy Code § 524(g), applies to asbestos cases and creates an elaborate protocol for matters within its scope. Prior to the passage of § 524(g), and since then for cases that do not fit within its contours, some plans with channeling injunctions have been proposed founded on Bankruptcy Code § 105. Whether a plan with a channeling injunction founded solely on § 105 should be confirmed raises a host of issues beyond the scope of this article. And it may well be that jurisdiction to consider whether to confirm such a plan includes "related to" jurisdiction. The Third Circuit dealt with this topic in In re Combustion Engineering, Inc., 391 F.3d 190, 43 Bankr. Ct. Dec. (CRR) 271, Bankr. L. Rep. (CCH) P 80206 (3d Cir. 2004), as amended, (Feb. 23, 2005). The plan at issue contained an injunction that would have channeled asbestos claims against two non-debtor subsidiaries to a trust. The bankruptcy court concluded that this plan passed muster and submitted proposed findings of fact and conclusions of law to the district court. The district court adopted those findings of fact and conclusions of law, and after making two modifications confirmed the plan. Id. at 202. The Third Circuit reversed. Since Bankruptcy Code § 524(g)(4)(A)(ii) does not include non-debtor subsidiaries in the universe of entities that can be protected by a channeling injunction, the proponents of the plan relied on § 105. The Third Circuit held that § 105 cannot provide a sufficient basis for such a plan, given the juxtaposition of the specific requirements of § 524(g), which were not satisfied. Id. at 235-238 ("The general grant of equitable power contained in § 105(a) cannot trump specific provisions of the Bankruptcy Code, and must be exercised within the parameters of the Code itself. . . Here, the Bankruptcy Court relied upon § 105(a) to achieve a result inconsistent with § 524(g)(4)(A). Although the Bankruptcy Court has broad equitable authority to craft remedies necessary to facilitate the reorganization of a debtor, this power is cabined by the Code."). The court also presumed that if the bankruptcy court were to exercise jurisdiction over the third-party claims that were to be channeled, it would need to do so under its "related to" jurisdiction over those claims. The court never considered, and therefore did not address, whether there might be "arising under" or "arising in" jurisdiction. The Third Circuit concluded that there were not sufficient factual findings in the record below to determine if there was "related to" jurisdiction over these third-party and expressed a narrow view of "related to" jurisdiction under the Pacor test. The Third Circuit would have remanded with respect to this issue but for its conclusion that even if "related to" jurisdiction existed, § 105 could not support the issuance of the channeling injunction. Id. at 233 ("Because there are insufficient findings of fact on the current record to assess the matter, we would ordinarily remand on the shared insurance issue [which might justify "related to" jurisdiction]. However, because we conclude § 105(a) does not permit the extension of a channeling injunction to the non-derivative claims against non-debtors . . ., no further fact finding is required on this point.").

[64]Voya contends that even if one accepts, *arguendo*, that a plan containing a nonconsensual third-party release can be confirmed, the specific plan before the court did not satisfy many of the relevant factors evaluated by courts that accept this premise. Needless to say, the plan proponents disagree. In this article, I have not tried to evaluate who has the better side of these arguments regarding the specific plan at issue.

[65]See note 9 supra.

[66]In re Airadigm Communications, Inc., supra note 10, 519 F.3d at 656.

[67]In re Seaside Engineering & Surveyors, Inc., supra note 10, 780 F.3d at 1079.

[68]Brubaker, "Revisiting Jurisdictional Precepts, supra note 8 at 12.

[69]Id.

[70]See, e.g., In re Seaside Engineering & Surveying, Inc., supra note 10, 780 F.3d at 1076, 1079 (relying solely on Bankruptcy Code § 105); Monarch Life Insurance Co. v. Ropes & Gray, supra note 10, 65 F.3d at 976 (same).

[71]See, e.g., Law v. Siegel, 134 S. Ct. 1188, 188 L. Ed. 2d 146, 59 Bankr. Ct. Dec. (CRR) 43, Bankr. L. Rep. (CCH) P 82592 (2014).

[72]Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206, 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).

[73]2 Collier on Bankruptcy ¶ 105.01[1] at 105-6 (16th ed., 2017, Alan N. Resnick and Henry J. Sommer, eds.).

[74]U.S. v. Sutton, 786 F.2d 1305, 1308, 14 Bankr. Ct. Dec. (CRR) 700, 14 Collier Bankr. Cas. 2d (MB) 681, Bankr. L. Rep. (CCH) P 71109 (5th Cir. 1986). See generally, Joshua Silverstein, "Hiding in Plain View: A Neglected Supreme Court Decision Resolves the Debate Over Non-Debtor Releases in Chapter 11 Reorganizations," 23 Emory Bankr. Dev. J. 13 (2006) at 31-39 (summarizing the case law adopting the narrow view of § 105(a)).

[75]2 Collier on Bankruptcy ¶ 105.01[1] at 105-6 to 105-7 (16th ed. 2017, Alan N. Resnick and Henry J. Sommer, eds.).

[76]Id.

[77]Id.

[78]See, e.g., In re Combustion Engineering, Inc., supra note 63, 391 F.3d at 224-225; In re Johns-Manville Corp., 801 F.2d 60, 63, 15 Bankr. Ct. Dec. (CRR) 319, 15 Collier Bankr. Cas. 2d (MB) 645 (2d Cir. 1986).

[79]Brubaker, "Revisiting Jurisdictional Precepts, supra note 8 at 13. Bankruptcy Code § 105(c) provides that "[t]he ability of any district judge or other officer or employee of a district court to exercise the authority or responsibilities conferred upon the court under this title shall be determined by reference to the provisions relating to such judge, officer, or employee set forth in title 28."

[80]Millennium District Court Remand, supra note 15 at 6 n.7, quoting In re Combustion Eng'g, Inc., supra note 63, 391 F.3d at 224-225.

[81]By "reorganization court" I mean either a district court exercising bankruptcy jurisdiction or a bankruptcy court.

[82]7 Collier on Bankruptcy ¶ 1123.01[5] at 1123-10 (16th ed. 2017, Alan N. Resnick and Henry J. Sommer, eds.).

[83]In re Dow Corning Corp., supra note 10, 280 F.3d at 656 ("Consistent with section 105(a)'s broad grant of authority, the Code allows bankruptcy courts considerable discretion to approve plans of reorganization. . . . Section 1123(b)(6) permits a reorganization plan to 'include any . . . appropriate provision not inconsistent with the applicable provisions of this title.' ").

[84]In re Airadigm Communications, Inc., supra note 10, 519 F.3d at 657 ("Section 105(a) codifies . . . the bankruptcy court's powers by giving it the authority to effect any 'necessary or appropriate' order to carry out the provisions of the bankruptcy code. . . And a bankruptcy court is also able to exercise these broad equitable powers within the plans of reorganization themselves. Section 1123(b)(6) permits a court to 'include any other appropriate provision not inconsistent with the applicable provisions of this title.'. . . In light of these provisions, we hold that this 'residual authority' permits the bankruptcy court to release third parties from liability to participating creditors if the release is 'appropriate' and not inconsistent with any provision of the bankruptcy code.").

[85]See, e.g., In re Drexel Burnham Lambert Group, Inc., 138 B.R. 723, 772 (Bankr. S.D.N.Y. 1992), aff'd on other grounds, 960 F.2d 285 (2d Cir. 1992); In re Charles Street African Methodist Episcopal Church of Boston, supra note 59, 499 B.R. at 81; In re American Family Enterprises, 256 B.R. 377, 406 (D.N.J. 2000); In re 710 Long Ridge Road Operating Company, II, LLC, 198 L.R.R.M. (BNA) 2659, 164 Lab. Cas. (CCH) P 10678, 2014 WL 886433 at *12 (Bankr. D. N.J. 2014).

[86]Silverstein, "Hiding in Plain View," supra note 74 at 31-41; Hydee Feldstein, "Reinterpreting Bankruptcy Code § 524(e): The Validity of Third-Party Releases in a Plan," 22 Cal. Bankr. J. No. 1 25, 38-40 ("the general grants of authority under Bankruptcy Code sections 105(a) and 1123(b)(5) are not mere precatory platitudes; they are substantive and significant grants of power to the bankruptcy courts."); Swallow, "The Power of the Shield —Permanently Enjoining Litigation Against Entities other than the Debtor—A Look at In re A.H. Robins Co., 1990 BYU L.Rev. 707, 723

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("section 1123(b)(5) supplies the grounds for an approach to approving a permanent Robins-style injunction provision that is not only compatible with both Sections 524(e) and 105(a), but also promotes the purposes of the Bankruptcy Code.").

[87]Supra note 59.

[88]Id., 499 B.R. at 81("The matter before the Court is not a suit on the Guaranty; the merits of the Guaranty are not in controversy.").

[89]Id., 499 B.R. at 80-81.

[90]N.L.R.B. v. Bildisco and Bildisco, 465 U.S. 513, 525, 527, 104 S. Ct. 1188, 79 L. Ed. 2d 482, 11 Bankr. Ct. Dec. (CRR) 564, 9 Collier Bankr. Cas. 2d (MB) 1219, 5 Employee Benefits Cas. (BNA) 1015, 115 L.R.R.M. (BNA) 2805, Bankr. L. Rep. (CCH) P 69580, 100 Lab. Cas. (CCH) P 10771 (1984).

[91]Millennium District Court Remand, supra note 15 at 5-6.

[92]In re Digital Impact, Inc., 223 B.R. 1, 11, 40 Collier Bankr. Cas. 2d (MB) 661 (Bankr. N.D. Okla. 1998).

[93]Peter Boyle, "Non-Debtor Liability in Chapter 11: Validity of Third-Party Discharge in Bankruptcy," 61 Fordham L.Rev. 421, 438 (1992) ("Advocates [of this argument] are essentially proposing the use of one catch-all provision to implement another catch-all provision. This approach results in bootstrapping to exert jurisdiction over the rights a creditor has against a non-debtor.").

[94]The Third Circuit made this point in In re Combustion Engineering, Inc., supra note 63, 391 F.3d at 228-229 (while "contributions [by a third party] may inure to the benefit of certain Combustion Engineering asbestos claimants, these factors alone do not provide a sufficient basis for exercising subject matter jurisdiction. If that were true, a debtor could create subject matter jurisdiction over any non-debtor third-party by structuring a plan in such a way that it depended upon third-party contributions. As we have made clear, 'subject matter jurisdiction cannot be conferred by consent of the parties. When a court lacks subject matter jurisdiction over a dispute, the parties cannot create it by agreement even in a plan of reorganization.' ") (citations omitted).

[95]Brubaker, "A Critical Reappraisal," supra note 8 at 1017 n. 209.

[96]Supra note 10, 168 B.R. at 935.

[97]From In re Dow Corning Corp., supra note 10, 280 F.3d at 658.

[98]From In re Continental Airlines, supra note 12.

[99]In re Seaside Engineering & Surveying, supra note 10, 780 F.3d at 1079.

[100]In re Master Mortgage, supra note 10, 168 B.R. at 935.

[101]In re Seaside Engineering & Surveying, supra note 10, 780 F.3d at 1079.

[102]Id. (quoting from Behrmann v. National Heritage Foundation, 663 F.3d 704, 712, 55 Bankr. Ct. Dec. (CRR) 221, 66 Collier Bankr. Cas. 2d (MB) 1282, Bankr. L. Rep. (CCH) P 82124 (4th Cir. 2011)); Monarch Life Ins. Co. v. Ropes & Gray, 65 F.3d 973, 979, 27 Bankr. Ct. Dec. (CRR) 1039, 34 Collier Bankr. Cas. 2d (MB) 313, Bankr. L. Rep. (CCH) P 76634 (1st Cir. 1995) (the test will be satisfied only in "extraordinary circumstances").

[103]See, e.g., NLRB v. Bildisco & Bildisco, supra note 90, 465 U.S. at 527 ("the policy of Chapter 11 is to permit successful rehabilitation of debtors. . .").

[104]Id., 465 U.S. at 525. As the Court stated, "the Bankruptcy Court must focus on the ultimate goal of Chapter 11 when considering these equities. The Bankruptcy Code does not authorize freewheeling consideration of every conceivable equity, but rather only how the equities relate to the success of the reorganization." Id. at 527.

[105]Brubaker, "A Critical Reappraisal," supra note 8 at 1015 (citing cases).

[106]Celotex Corp. v. Edwards, supra note 40.

[107]Id., 514 U.S. at 310.

[108]Id., 514 U.S. at 310.

[109]In re Seaside Engineering & Surveying, supra note 10, 780 F.3d at 1079. See also, In re Master Mortgage Investment Fund, Inc., supra note 10, 168 B.R. at 934-35.

[110]See, e.g., In re Dow Corning Corp., supra note 10, 280 F.3d at 658 ("There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate. . ."); In re Monarch Life Insurance Co., supra note 10, 65 F.3d at 980; In re Airadigm Communications, Inc., supra note 10, 519 F.3d at 657; In re Charles Street African Methodist Episcopal Church of Boston, supra note 59, 499 B.R. at 83-84.

[111]In re Johns-Manville Corp., 600 F.3d 135, 146, 150-52 (2010), cert den., 562 U.S. 1082 (distinguishing between " 'direct action[s] against an insurer [under the policy] when the insured is insolvent' " and "claims that 'seek to recover directly from the debtor's insurer for the insurer's own independent wrongdoing' ").

[112]Feldstein, supra note 86 at 45.

[113]A mathematical example may help. Assume that the creditor asserts a claim against the debtor for $100 and a claim against a third-party for $1,000. If the debtor liquidated—and, as a result, there was no third-party release—the creditor would be entitled to recover $1,000 against the third-party. A chapter 11 plan containing a third-party release and that provided for a 100% recovery on the creditor's claim against the debtor (i.e., $100) would leave the creditor at least $900 worse off than if the debtor had liquidated and the creditor had pursued the third party.

[114]In her most recent decision, Judge Silverstein commented on this confusion. Millennium Bankruptcy Court Decision, supra note 4, at n.160.

[115]See, e.g., In re Master Mortgage Investment Fund, Inc., supra note 10, 168 B.R. at 935; In re Seaside Engineering & Surveying, Inc., supra note 10, 780 F.3d at 1079.

[116]See, e.g., In re Continental Airlines, supra note 12, 203 F.3d at 215 ("we have found no evidence that the non-debtor D&O's provided a critical financial contribution to the Continental Debtor's plan. . ."). Some courts have incorrectly considered the non-debtor's waiver of a claim for indemnification to be a material contribution. Indemnification claims provide little, if any, value since they are typically disallowed under Bankruptcy Code § 502(e)(1)(B) and, even if allowed, typically do not have much of a dilutive impact on the distributions to other creditors. See Brubaker, "A Critical Reappraisal," supra note 8 at 1002-1009.

[117]In re Master Mortgage Investment Fund, Inc., supra note 10, 168 B.R. at 935.

[118]Id. at 935. See also, In re Long Ridge Road Operating Company, II, LLC, supra note 85, 2014 WL at *14; In re Seaside Engineering & Surveying, Inc., supra note 10, 780 F.3d at 1079.

[119]See, e.g., Brubaker, "A Critical Reappraisal," supra note 8 at 981-986; Silverstein, "Hiding in Plain View," supra note 74 at 74-75.

[120]Supra note 10.

[121]Id., 792 F.2d at 1152.

[122]Brubaker, "A Critical Reappraisal," supra note 8 at 984 n.88.

[123]Bankruptcy Code § 1129(b)(1) requires that a plan be fair and equitable with respect to any dissenting class. As Hydee Feldstein argued, "It should never be fair or equitable to confirm a plan requiring a dissenting class to release a nondebtor from a claim not held by other classes." Feldstein, supra note 86 at 43. See also, Silverstein, "Hiding in Plain View," supra note 74 at 75 (a "third-party release will not pass muster if the impacted class objects" and noting that the bankruptcy court in Robins observed that the debtor's plan could not have been crammed down on the class of Dalkon Shield claimants if "there was *any* chance that they would not receive payment in full.") (emphasis in original).

[124]"Overwhelming" is not defined with precision, which should not be surprising since the Master Mortgage factors are non-exhaustive and no one of them is dispositive; pro-release courts consider them in combination. But as noted in the text, Bankruptcy Code §§ 1122(a), 1123(a)(4), 1126(c) and 1129(b) require that at least 2/3 in amount and more than 50% in number of the creditors with third-party claims who vote support the plan.

[125]In re Master Mortgage, supra note 10, 168 B.R. at 935. See also, In re Seaside Engineering, supra note 10, 780 F. 3d at 1079; Monarch Life Ins. Co. v. Ropes & Gray, supra note 10, 65 F.3d at 980; In re 710 Long Ridge Road Operating Company, II, LLC, 198 L.R.R.M. (BNA) 2659, 164 Lab. Cas. (CCH) P 10678, 2014 WL 886433 at *14 (Bankr. D. N.J. 2014).

[126]See, e.g., Brubaker, "A Critical Reappraisal," supra note 8 at 991-994; Silverstein, "Hiding in Plain View," supra note 74 at 76-78; Joshua Silverstein, "Overlooking Tort Claimants' Best Interests: Non-Debtor Releases in Asbestos Bankruptcies," 78 UMKC L.Rev. 1, 75-83 (2009).

[127]See Silverstein, "Overlooking Tort Claimants' Best Interests," supra note 126 at 86 ("Suppose a group of asbestos plaintiffs holds claims of questionable validity against the third arties shielded by a supplemental injunction. In a Chapter 7 liquidation, the plaintiffs would receive only pro rata payments from the insolvent debtor['s liquidation] and likely noth-

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ing from the third parties.”).

[128]Feldstein, supra note 86 at 45.

[129]United Artists Theatre Co. v. Walton, 315 F.3d 217, 227, 40 Bankr. Ct. Dec. (CRR) 182, 49 Collier Bankr. Cas. 2d (MB) 1434, Bankr. L. Rep. (CCH) P 78777 (3d Cir. 2003) (Continental Airlines requires “that the releases ‘were given in exchange for fair consideration’ ”).

[130]In re Seaside Engineering & Surveying, supra note 10, 780 F.3d at 1081; In re W.R. Grace & Co., 446 B.R. 96, 137-140 (Bankr. D. Del. 2011).

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A New *Millennium* of Article III Analysis: Which Court—a Bankruptcy Court or a District Court—Must Decide Whether to Confirm a Plan that Contains a Nonconsensual Third-Party Release? (Part II)

*By Ben H. Logan**

Author's note: Prior to my retirement on January 1, 2015, I was a partner in O'Melveny & Myers LLP. While at O'Melveny, I was part of the team that represented the debtor before the Court in Wellness International Network, Ltd. v. Sharif, 135 S. Ct. 1932 (2015). I mention this since it is conceivable that, notwithstanding my best efforts to the contrary, this colors my analysis. None of the views expressed herein should be ascribed to O'Melveny, its clients or, indeed, anyone other than me personally. In addition, I reserve the right to change my mind at the drop of a hat.

I am deeply indebted to Professor Ralph Brubaker, the Editor in Chief of this publication, for his input. However, the views expressed herein definitely should not be ascribed to him. Ralph and I have sparred publicly over Article III jurisdictional issues and have carried on an extensive private dialogue. Ralph has written expansively and thoughtfully on third-party releases and bankruptcy jurisdiction. It is with substantial trepidation that I write on these topics in his publication, particularly since he and I disagree in some respects.

Introduction (Part II)

This is the second installment of a two-part article in which I explore the constitutional question recently decided by Bankruptcy Judge Silverstein in *Millennium Lab*[1]—i.e., whether Article III of the Constitution allows Congress to authorize a bankruptcy court to decide whether a chapter 11 plan containing a nonconsensual third-party release should be confirmed or, instead, requires that this determination be made by a district court.

As explained in Part I,[2] the majority view is that the Bank-

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ruptcy Code authorizes confirmation of a plan containing a nonconsensual third-party release if certain tests are met. Some, including the Editor-in-Chief of this publication, disagree with that conclusion. If they are right, no court (even a district court) can confirm such a plan. In this article, I have done my utmost to avoid weighing in on that debate. Rather, I take as a given (as must courts in circuits that follow the majority view) that such a plan can be confirmed and instead address the constitutional question—*which* court (a non-Article III bankruptcy court or an Article III district court) must decide whether or not to confirm a plan containing a third-party release.

Of course, this constitutional issue arises because bankruptcy judges do not have the life tenure or salary protection required by Article III for judges that exercise the "[t]he judicial Power of the United States."[3]

Exploring this constitutional question requires a threshold analysis as to whether the jurisdiction exercised by a court that follows the majority view is "related to" jurisdiction over a third-party claim that is released or "arising in"/"arising under" jurisdiction to confirm a plan under the provisions of the Bankruptcy Code. Part I, published in last month's issue of the *Bankruptcy Law Letter*, explores this threshold issue.

As explained in Part I, if a court exercises "related to" jurisdiction over a third-party claim, there is probably neither a statutory jurisdictional basis nor a credible constitutional theory under which a bankruptcy court could enter a final decision confirming the plan; the bankruptcy court would have to submit proposed findings of fact and conclusions of law to the district court.

Moreover, if a court exercises "related to" jurisdiction over a third-party claim, no court (including the district court) will have a basis under the relevant law—i.e., the law governing that third-party claim—to force the claimant to release that claim or allow the court to dispose of the claim without addressing the merits. Phrased differently, it would be nonsensical for a court to use "related to" jurisdiction over a third-party claim to force the claimant to release that claim. Instead, if a court were to exercise "related to" jurisdiction over a third-party claim, the court would preside over full-blown litigation of that claim and would decide it on the merits.

But that is not what is going on when a court that follows the majority view confirms a

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chapter 11 plan that contains a third-party release. A court that evaluates whether to confirm such a plan, evaluates whether the substantive provisions of the Bankruptcy Code authorize confirmation of such a plan irrespective of the merits of the third-party claim. As explained in Part I of this article, this is an exercise of “arising under” and/or “arising in” jurisdiction to decide whether to confirm a chapter 11 plan pursuant to the Bankruptcy Code rather than the exercise of “related to” jurisdiction over the third-party claim.

For this to be a proper exercise of “arising under” or “arising in” jurisdiction, it is critical that the courts that hew to the majority view decide whether to confirm (or not to confirm) such a plan based on the Bankruptcy Code rather than general equitable principles. As a result, Part I of this article explores this topic at length. And as explained in last month’s issue of the *Bankruptcy Law Letter*, the majority view (whether right or wrong) is tied to specific provisions of the Bankruptcy Code, including §§ 1122, 1123, 1126, and 1129. In other words, in determining whether to confirm a plan containing a nonconsensual third-party release, a court in a jurisdiction that follows the majority view must probe whether a plan with a third-party release satisfies the confirmation standards of the Bankruptcy Code.

Once one accepts that premise, the constitutional analysis is comparatively straightforward.[4] It seems almost sacrilegious to question whether a bankruptcy court can decide whether to confirm a chapter 11 plan—or at least most chapter 11 plans. Nothing is more central to the chapter 11 process. As Collier points out, it is clear beyond peradventure that a bankruptcy court can decide whether to confirm a chapter 11 plan. “This has been true since the regime of the Bankruptcy Act and remains true today, even under *Marathon*, *Granfinanciera, S.A. v. Nordberg* and *Stern v. Marshall*.”[5]

Why is it clear that a bankruptcy court can constitutionally confirm a chapter 11 plan and why doesn’t the inclusion of a third-party release change the analysis? There are several reasons.

I. Confirmation of a Plan Containing a Third-Party Release is the Type of Collective Matter that “Stems From the Bankruptcy Itself.” There is no Common Law Corollary

A. The Court’s Articulation of What Can and Cannot Be Assigned to a Non-Article III Bankruptcy Judge

As Justice Rehnquist famously put it in *Marathon*, the Court’s Article III analysis does “not admit of easy synthesis”[6] and I will not even pretend to try to plumb the full contours of what a non-Article III bankruptcy judge can and cannot do. Fortunately a complete analysis of this topic is not necessary, for confirmation of a chapter 11 plan is the sort of collective process dependent entirely on bankruptcy law that fits well within the Court’s Article III jurisprudence.

1. One-off litigation versus the umbrella bankruptcy case

The Court’s Article III bankruptcy cases have, by and large, explored what is impermissible under Article III rather than explaining why it is constitutional for a bankruptcy court to enter a final decision on any matter (without consent). Almost all of the Court’s decisions on this topic deal with litigation brought as an adversary proceeding. These litigations are important to the chapter 11 process, but less central than the multi-party matters that are conducted under the umbrella of the main bankruptcy case—e.g., DIP financing, 363 sales, and (perhaps most important of all) confirmation of a plan of reorganization. As the Court has consistently explained, historically these litigations were not considered part of the main bankruptcy proceedings—and that remains the situation today.[7] Suits brought by

a trustee (or other estate representative) against a third party can be extremely important to a bankruptcy case. But they are separate litigations—generally two-party disputes[8]—designed to "augment the estate."[9]

2. A matter that stems from the bankruptcy itself

The key test was articulated in *Stern v. Marshall* when the Court juxtaposed a tortious interference counterclaim to an "*action that stems from the bankruptcy itself* or would necessarily be resolved in the claims allowance process."[10] In so doing, the Court contrasted matters that are the essence of a chapter 11 case to the debtor's tortious interference claim which was "in no way dependent upon bankruptcy law" and would "exist[] without regard to any bankruptcy proceeding."[11] In other words, the line of demarcation is between (1) matters that are peculiarly a matter of bankruptcy law, have no common law corollary, and are central to the collective process that includes the most essential functions of a reorganization court, and (2) one-off litigation that, while important, is not the type of collective matter that is central to a bankruptcy proceeding.[12]

3. But is it of the stuff traditionally tried before courts?

If a substantive right is set forth in the Bankruptcy Code, jurisdiction is "arising under," and it might be said that the matter "stems from the bankruptcy itself." But it may still be unconstitutional for a non-Article III court to enter a final judgment (without consent) if that substantive right has a common law corollary—i.e., it is of the "stuff tried before the courts at Westminster." That is the import of *Katchen v. Landy* (involving a preference),[13] *Granfinanciera v. Nordberg* (involving a fraudulent conveyance),[14] and *Langenkamp v. Culp* (involving a preference).[15] Even though sections of the Bankruptcy Code (and the 1898 Act before it) establish these causes of action,[16] they are not part of the main bankruptcy proceedings and were traditionally plenary matters tried in non-bankruptcy courts. As the Court put it in *Granfinanciera*, they " 'constituted no part of the proceedings in bankruptcy' " and are "quintessentially suits at common law that more nearly resemble state-law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditor's hierarchically ordered claims to a pro rata share of the bankruptcy res."[17] The *Granfinanciera* Court acknowledged that a fraudulent conveyance cause of action may be very important to the bankruptcy case—augmenting the estate often is. But bringing such a suit to augment the estate is not "integral to restructuring of debtor-creditor relations."[18] So unless the creditor has filed a claim such that resolution of the fraudulent conveyance or preference action is a necessary component of resolving whether to allow that claim—a "matter of administration" of the main bankruptcy case within the traditional summary jurisdiction of a non-Article III bankruptcy tribunal—a bankruptcy court may not enter a final judgment (without consent). Even though the exact issue in these cases was the right to a trial by jury under the 7th Amendment, and therefore there is some room for debate, in *Granfinanciera*, the Court explained that "whether the *Seventh Amendment* permits Congress to assign its adjudication to a tribunal that does not employ juries as factfinders requires the same answer as the question whether Article III allows Congress to assign adjudication of that cause of action to a non-Article III tribunal."[19] Thus, in *Executive Benefits Insurance Agency v. Arkison*,[20] the parties accepted the premise (as decided by the Ninth Circuit below) that a fraudulent conveyance action was not the sort of matter that could constitutionally be delegated to a non-Article III bankruptcy court (without consent). The *Arkison* Court accepted this premise without needing to decide it directly.[21]

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This aspect of *Granfinanciera* follows a long line of cases in which the Court has been clear—and consistent—that Article III prevents Congress from withdrawing "from judicial cognizance any matter which, *from its nature*, is the subject of a *suit* at the common law, or in equity, or admiralty." The Court first coined this phrase in *Murray's Lessee v. Hoboken Land and Improvement Co.*,[22] and underscored its importance by admonishing that it was doing so in order "[t]o avoid misconception upon so grave a subject."[23] Since 1856, the Court has consistently quoted this passage from *Murray's Lessee* in its Article III decisions,[24] including essentially all of its Article III bankruptcy decisions.[25] Phrased slightly differently, the Court has emphasized that "[w]hen a *suit* is made of 'the stuff of the traditional actions at common law tried by the courts at Westminster in 1789 . . . and is brought within the bounds of federal jurisdiction, the responsibility for deciding that *suit* rests with Article III judges in Article III courts."[26]

It is no accident that the *Granfinanciera* Court used the word "suit" to describe the sort of matter reserved for Article III adjudication. The Court has long recognized that "jurisdiction . . . of all *suits* at law or in equity. . . is the regular jurisdiction between *party and party*, as described in the Judiciary Act and the third article of the Constitution."[27] So the sort of matter that requires Article III adjudication generally involves a plaintiff and defendant, proceeds before a court pursuant to the full rules of civil procedure and ultimately results in a disposition on the merits of the claim.

4. Application to a plan containing a third-party release

So does it matter that a plan contains a third-party release? Asked differently, does this transmogrify a matter that could have been determined by a bankruptcy court into a matter reserved for a district court? The answer is no—because confirmation of a plan is the culmination of a multi-party omnibus proceeding that has no common law corollary and where all of the issues "stem from the bankruptcy itself." The relevant issues are matters purely of bankruptcy law that go to the heart of the collective process of confirming a plan, with no analogy to the stuff of classic litigation tried before non-bankruptcy courts.

All of the issues that a court is to consider in determining whether to confirm a plan containing a third-party release are purely matters of bankruptcy law, most particularly the confirmation standards set forth in chapter 11—e.g., does the plan properly classify the objecting creditor with other creditors who have third-party claims, has that class voted overwhelming to accept the plan (i.e., is the objector a hold-out), does the plan satisfy the best interests test (which requires that the complaining creditor be no worse off than if the debtor liquidated and the creditor was free to pursue its third-party claim), is the third-party claim essentially identical to the claim against the debtor, and has the beneficiary of the release made a substantial contribution that is essential to the success of a reorganization. The first part of this article waxes on regarding the bankruptcy law factors that pro-release courts consider because the fact that these are purely bankruptcy law issues has a significant impact on the constitutional analysis.

Nor is there any common law corollary to a provision in a chapter 11 plan providing for the *release* of a third-party claim. Exactly to the contrary, if a court were to preside over a cause of action arising in the common law (or established by a non-bankruptcy statute), that court would preside over litigation in which the merits were determined—rather than considering whether bankruptcy law allows

such claims to be released irrespective of their merits.

Confirmation of a chapter 11 plan has none of the hallmarks of a suit that traditionally must be tried before a non-bankruptcy court. There is no plaintiff and no defendant. It is not a litigation "between party and party, as described in the Judiciary Act and the third article of the Constitution."[28] Rather, confirmation of a plan is an omnibus unitary proceeding providing for the overall reorganization of a debtor and which affects a multitude of parties and issues.

In *Marathon*, the plurality suggested that "restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power . . . may well be a 'public right.' "[29] The Court did so in the context of exploring the possibility of using the "public rights" doctrine (articulated decades earlier in *Crowell v. Benson*) as a foundation for its Article III bankruptcy analysis. Since *Marathon*, the Court has increasingly backed away from trying to use the "public rights" doctrine in the bankruptcy context[30] so the phraseology used in the plurality opinion in *Marathon*—"restructuring of debtor-creditor relations"—has less currency than the test adopted by the Court in *Stern*—an "action that stems from the bankruptcy itself." Even so, the Court has used the phraseology "integral to restructuring of debtor-creditor relations" in contexts other than the "public rights" doctrine[31] and it is worthwhile to explore whether a plan that contains a third-party release fits this rubric.

Does confirmation of a plan containing a third-party release involve "restructuring of debtor-creditor relations"? Absolutely. As explained in the first part of this article, such a plan can be confirmed only if certain tests are met including: (a) the party who objects has claims against the debtor (i.e., the objector is a creditor), (b) there is such a substantial identity between the claims that the objecting creditor asserts against the debtor and its third-party claims that the damages asserted in these two claims are the same, (c) the beneficiary of the release is invariably also a creditor of the debtor, (d) the beneficiary of the release makes a contribution that is essential to the restructuring of the relations between the debtor and its creditors, including the class of creditors who have third-party claims, and (e) holders of at least 2/3 in amount and more than 50% in number of creditors also holding third-party claims believe that these contributions justify voting in favor of the plan. The fact that restructuring the debtor-creditor relationship also affects the relations between two non-debtors does not negate the fact that the release is an integral part of restructuring the relations between the debtor and its creditors.

It is not unusual for a chapter 11 plan to have an impact on rights between creditors *inter se*. For example, it is common in modern financing transactions for an intercreditor agreement to give non-debtor creditors rights vis-á-vis each other—these agreements provide that senior creditors can require junior creditors to turn over distributions until the senior creditor is paid in full (often in cash). But Bankruptcy Code § 1129(b) provides that these rights that each senior creditor has against each junior creditor can waived if the seniors accept the plan by class vote.[32] This brings up a related point—if it is a district court, rather than a non-Article III bankruptcy court, that must consider whether to confirm a plan that contains a third-party release, leverage of the sort that chapter 11 is intended to avoid will be given to hold-outs.

In her recent decision, Judge Silverstein gives other examples of how bankruptcy plans can affect the rights of non-debtors *inter se*. Many of the cases on which she relies illustrate that the fact that a confirmation order may have a preclusive impact on claims between two non-debtors does not mean that the bank-

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ruptcy court exercises "related to" jurisdiction to decide the merits of the third-party claims[33]—a topic explored at length in Part I of this article.[34]

Judge Silverstein is not alone in grappling with these issues. The appropriate analysis was well synthesized in one of the few other post-*Stern* cases directly on point. In *Charles Street African Methodist Episcopal Church of Boston*,[35] the bankruptcy court declined to confirm a plan containing a third-party release (a release of a guarantee) on the grounds that it failed to satisfy the substantive tests set forth in the Bankruptcy Code. But the bankruptcy court also held that it had the constitutional authority to make these determinations. The *Charles Street* court rejected the contention that it could confirm a plan containing a third-party release only by exercising "related to" jurisdiction over the third-party claim, noting that the "merits of the "Guaranty are not in controversy."[36] The court then explained:

> The matter before the Court is a plan of reorganization, the confirmation of which arises under title 11, the Bankruptcy Code. It is what chapter 11 is all about, see 11 U.S.C. §§ 1121 - 1144, the quintessential bankruptcy matter. It is not the mere adjudication of a single claim by a creditor against a third-party guarantor but a unitary omnibus civil proceeding for the reorganization or adjustment of all obligations of the debtor and disposition of all the debtor's assets. It may or may not be appropriate for a court exercising bankruptcy jurisdiction to confirm a plan containing a third-party release—and, if it is appropriate, the manner and degree of relation of the released claim are certainly factors in the analysis—but the court undoubtedly has jurisdiction to adjudicate the plan, even without recourse to its related-to jurisdiction.
>
> Citing *Stern v. Marshall* . . ., [the plan opponent] argues that approval of the release is tantamount to adjudication of the guaranty, which, as a two-party dispute that arises under state law between non-debtor parties, cannot constitutionally be adjudicated by a non-Article III judge, even if that controversy is part of a statutorily defined 'core proceeding' in 28 U.S.C. § 157(b). Again, the Court disagrees. The matter before the Court is not a suit on the Guaranty; the merits of the Guaranty are not in controversy. To reiterate, the matter before the Court is the confirmation of a plan, a unitary omnibus civil proceeding for the reorganization of all obligations of the debtor and disposition of all its assets. Confirmation of a plan is not an adjudication of the various disputes it touches upon—the Guaranty being here but one of many; it is a total reorganization of the debtor's affairs in a manner available only in bankruptcy. The release may be proposed and approved only as part of a plan and only (if at all) pursuant to powers of adjustment afforded by the Bankruptcy Code, such as in sections 1123(a)(5) and 105(a). Accordingly, the confirmation of a plan—including any third-party release it may propose—is a matter of 'public rights' that, under *Stern*, Congress may constitutionally assign to a non-Article III adjudicator, *Stern*, 131 S.Ct. at 2618 (the question is 'whether the action at issue stems from the bankruptcy itself' and thus falls within one of the limited circumstances covered by the public rights exception). There is no constitutional infirmity in Congress's having provided, in 28 U.S.C. § 157(b)(1) and (b)(2)(L) that confirmation of a plan, including one of the variety here presented, is a proceeding that a bankruptcy judge may hear, determine, and enter appropriate orders and judgment on."[37]

Judge Silverstein also captured this point in her recent decision. "[T]here is no state law equivalent to confirmation of a plan. And, third party releases do not exist without regard to the bankruptcy proceeding. Rather, a ruling approving third party releases is a determination that the plan at issue meets the federally created requisites for confirmation and third party releases."[38]

B. Historic Practice

Some of the Court's jurisprudence takes guidance from bankruptcy practice in 18th Century England and under predecessor U.S. bankruptcy statutes—particularly the Bank-

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ruptcy Act of 1898.[39] So it is appropriate to consider what insights one can glean from the relevant history.

1. 18th Century England

English bankruptcy practice as of the time of the drafting of the Constitution is relevant for presumably the sort of matters that were tried in the English courts in 1789 were what the Framers had in mind when they spoke of "Cases in Law and Equity" that constituted an exercise of the judicial power.[40]

In 18th Century England, "a bankruptcy case began when creditors filed a petition with the Lord Chancellor alleging that an individual who was a 'merchant' had committed an 'act of bankruptcy.' "[41] The Lord Chancellor then issued against the bankrupt a "Commission of Bankruptcy" which among other things named 5 commissioners to "conduct the bankruptcy proceedings."[42] These commissioners were not judges. But their functions were quasi-judicial. They decided "almost all of the issues arising in the bankruptcy proceeding," including "the administration of the estate and the case, the eligibility of the bankrupt, the property of the bankrupt, the allowance of claims of the creditors, the distribution of the bankrupt's assets and the discharge of the bankrupt's debts."[43] Unlike the sort of litigation conducted before the courts, bankruptcy proceedings were collective proceedings in which all of the bankrupt's creditors were entitled to participate without formally intervening or anyone instituting a suit or serving a summons. Bankruptcy proceedings did not have a plaintiff or defendant, used less formal procedures than were employed by the courts of law and equity and moved faster than litigation in the courts. In contrast, when it was necessary to try to collect debts owed to the bankrupt or to "recover property of the bankrupt" held under a credible adverse claim, formal suit was required. That litigation was brought by an "assignee"—what we would today call a trustee—who sued the defendant "usually in the law courts but sometimes in the Court of Chancery."[44] Formal suits of this sort were called "plenary," as contrasted to the "summary" bankruptcy proceedings conducted by commissioners.

Applying bankruptcy practice in 18th Century England to the issues at hand is complicated by the fact that nothing in the law at the time—neither the law governing actions in the courts nor the law applicable to bankruptcy commissioners—provided for anything comparable to chapter 11 plan containing a third-party release.

So in 18th Century England there was no action that had to be tried before the courts at Westminster that is comparable to a third-party release set forth in a bankruptcy plan. In that sense the Court's frequent admonitions regarding matters historically tried before the courts at Westminster would indicate that these issues need not be decided by an Article III court.

It is also true that a plan of reorganization containing a third-party release would not be a concept with which an 18th Century English bankruptcy commissioner would have been familiar. But 18th Century English bankruptcy commissioners would have been familiar with little of what transpires in a modern chapter 11 case, including matters that go to the heart of a modern reorganization. In 18th Century England, bankruptcy was restricted to insolvent merchants and simply involved liquidation of their assets. There was no such thing as a corporate reorganization, much less a corporate reorganization with a third-party release. But that should not be telling, for courts have long rejected the argument that the Constitution restricts bankruptcy law to the substantive law in 18th Century England.[45]

In sum, while the analogy to 18th century English bankruptcy practice is far from perfect,

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the line of demarcation drawn in 18th Century England between collective matters that were handled by bankruptcy commissioners and one-off litigation brought on behalf of the estate in the courts suggests that confirmation of a chapter 11 plan (including a plan with a third-party release) is not the sort of matter that the Framers had in mind in Article III.

2. The Bankruptcy Act of 1898

The Bankruptcy Act of 1898 borrowed some of its procedural framework from 18th Century England, but obviously applied that structure to evolving and expanding matters. As a result, the Court has sometimes looked to practice under the 1898 Act in determining the contours of what Article III allows. Professor Brubaker has gone so far as to argue that the Court has "constitutionalized" the summary/plenary divide under 1898 Act.[46] I think that is an overstatement. Our disagreement primarily relates to how much weight to give to cases decided under the 1898 Act and the precise line of demarcation between summary and plenary matters under the 1898 Act. That debate is a diversion from the topic at hand for there is no question that the Court has sometimes looked to practice under the 1898 Act as a "guidepost for determining the constitutionality of non-Article III bankruptcy adjudications."[47]

Most important for present purposes, as originally enacted, § 23 of the 1898 Act severally limited the jurisdiction of "courts of bankruptcy" to decide plenary matters. Section § 23 drew a line of demarcation between (i) "proceedings under this Act," and (ii) "*suits* by the trustee" involving "controversies at law and in equity . . . between receivers and trustees as such and adverse claimants, concerning the property acquired or claimed by the receivers or trustees."[48] The former were summary proceedings and could be determined by "courts of bankruptcy." The latter were plenary suits and § 23a provided that they could be tried in federal courts only "in the same manner and to the same extent as though such proceedings [i.e., bankruptcy proceedings] had not been instituted and such controversies had been between the bankrupt and such adverse claimants."[49] Section 23(b) buttressed this by providing that "[s]uits by the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this Act had not been instituted, unless by consent of the defendant."[50] Thus, as originally enacted, the 1898 Act required that suits brought by a trustee against an adverse claimant be brought in a court other than a "court of bankruptcy"—usually a state court or occasionally a federal district court that had diversity jurisdiction. So as originally enacted, the 1898 Act precluded Article III district courts sitting in bankruptcy—much less the referees to whom § 38 of the 1898 Act allowed these courts to refer certain matters—from hearing plenary matters without consent.

In the years that followed, Congress amended the 1898 Act to allow "courts in bankruptcy" to try a variety of plenary matters. For example, in 1903 and again in 1910, Congress expanded the jurisdiction of the "courts of bankruptcy" by amending § 23b and the corresponding provisions of §§ 60, 67 and 70 to provide that a "court of bankruptcy" had jurisdiction to determine suits to recover preferences and fraudulent conveyances.[51] And when Congress passed the Chandler Act in 1938, it amended § 23 to make it inapplicable to Chapter X proceedings.[52] So over much of the time it was in effect, the 1898 Act provided that "courts of bankruptcy" had jurisdiction over many plenary matters.

However, under the 1898 Act, jurisdiction over plenary matters could not be exercised (without consent) by the non-Article III referees to whom bankruptcy courts referred summary matters.[53]

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Summary jurisdiction entrusted to referees fell into two broad categories: (i) "matters of administration," and (ii) disputes over property within "the actual or constructive possession of the court." Determining whether property was within the "actual or constructive possession" of the court turned on a confusing and complicated array of factors and was the subject of an enormous amount of litigation.[54] But fortunately, the relevant issue here falls within the other major type of summary jurisdiction—what were called "matters of administration."

The terminology "matters of administration" was not intended to connote that these matters were mundane or did not involve disputes. Rather, the heart of what transpired in a bankruptcy proceeding fit this rubric. As the 14th Edition of Collier explained, "[i]n corporate reorganization, as in ordinary bankruptcy, the court clearly has summary jurisdiction over all **matters of administration** beginning with the filing of the petition and ending with the entry of the final decree—matters such as the proof and allowance of or disallowance of claims, classification of creditors and stockholders, approval of compromises, appointment of receivers and trustees, **approval and confirmation of the plan**, examination and investigation of the debtor, determination of fees and allowances, and the like."[55] Thus, under the 1898 Act, confirmation of a plan, as well as the other matters that were central to what we now call the main bankruptcy case, were summary proceedings. To use the Court's current terminology, they were (and remain) matters that "stem from the bankruptcy itself" and were (and remain) central to "restructuring the debtor-creditor relations."

Summary matters that fell within the umbrella of "matters of administration" were collective proceedings that lacked the hallmarks of traditional litigation. Just like the collective "proceedings in bankruptcy" conducted by 18th Century English commissioners, in these summary proceedings there was no plaintiff or defendant and they generally moved faster than litigation in non-bankruptcy courts. Summary matters involving "matters of administration" were initiated by petition or an order to show cause that served to bring in the entire panoply of participants in a bankruptcy proceeding, rather than a summons served on a defendant.[56] In other words, under the 1898 Act, all issues related to confirmation of a plan were part of summary proceedings entrusted to non-Article III tribunals. Similarly, confirmation of a chapter 11 plan under the current Bankruptcy Code involves a collective "proceeding in bankruptcy"—indeed, the most important, and prototypical, example of the collective proceedings conducted under the umbrella of the main chapter 11 case. So to the extent we look to the 1898 Act for guidance, it suggests that confirmation of a plan containing a nonconsensual third-party release can be decided by a bankruptcy court.

In one of his articles on third-party releases, Professor Brubaker contends that courts under the 1898 Act "rejected occasional efforts to obtain permanent non-debtor releases through a plan of reorganization—most of which involved plan provisions that purported to release contractual guarantors from their personal liability for the debtor's obligations."[57] At first blush, this might give one pause for concern about the constitutionality of a current bankruptcy court confirming a plan that contains a third-party release. But these cases decided under the 1898 Act turned on an interpretation of a substantive provision of the 1898 Act which courts generally believed precluded confirmation of a plan that contained a third-party release. The relevant question was whether the 1898 Act allowed any court to confirm such a plan, rather than whether these issues had to be decided by a district court.

Whether the 1898 Act authorized any court to confirm a plan that contained a third-party release involved an interpretation of § 16 of

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the 1898 Act. Section 16 provided that the "liability of a person who is a co-debtor with a guarantor or in any manner a surety for, a bankrupt *shall not be altered* by the discharge of the debtor."[58] Section 524(e) of the current Bankruptcy Code is the successor to § 16. When Congress passed the Bankruptcy Code it deleted the language in italics quoted above so that current § 524(e) is simply a statement of the effect of a discharge, rather than a statement of what a court *shall not do*. As a result, the language of the current Bankruptcy Code provides a weaker case for the argument that substantive bankruptcy law prohibits confirmation of a plan containing a third-party release than did the 1898 Act. The Seventh Circuit made exactly this point in *In re Specialty Equipment Companies, Inc.*,[59] when it held that under the Bankruptcy Code it is proper for a plan to include a third-party release. In *Specialty Equipment*, the Seventh Circuit distinguished *Union Carbide Corp. v. Newboles*,[60] an earlier Seventh Circuit decision that had held that § 16 of the 1898 Act prohibited a plan from including a third-party release. The Seventh Circuit explained that its earlier decision was based on "Section 16 of the Bankruptcy Act of 1898, which is more explicit than section 524(e) of the current Bankruptcy Code."[61]

Clearly Congress can change the substantive provisions of the Bankruptcy Code and, thereby, change what is required for confirmation of a plan. That is what happened here.[62] That goes to question whether any court should confirm a plan under the substantive provisions of relevant bankruptcy law, not whether these issues must be decided by an Article III tribunal. There is no indication in any of these cases decided under the 1898 Act that it was improper for a bankruptcy court to decide these questions—the issue was what the Bankruptcy Act of 1898 required substantively, not which court could decide the matter. Moreover, it is an overstatement to contend that courts that interpreted the 1898 Act universally rejected confirmation of plans that contained a release of third-party claims. That is exactly what happened in *Stoll v. Gottlieb*[63] and Professor Brubaker cites some other examples.[64]

Most importantly, the question for constitutional purposes is not who was right and who was wrong in interpreting the 1898 Act (or the current Bankruptcy Code). The constitutional question is whether these issues can be decided by a non-Article III bankruptcy court. The answer to that question is yes, for evaluating whether a chapter 11 plan can be confirmed is the quintessential example of—using terminology from the 1898 Act —a summary matter involving "matters of administration." Or using the Court's more current phraseology, these matters "stem from the bankruptcy itself." Deciding whether a plan—including a plan with a third-party release—should be confirmed is part of a collective unitary proceeding unique to chapter 11. There is no common law corollary.

Conclusion

Until recently, most of the debate regarding whether a chapter 11 plan can contain a third-party release centered on whether this is allowed by the Bankruptcy Code.

Seventeen years ago, the Third Circuit Court of Appeals highlighted that these plans present an additional and "very significant issue"—whether a non-Article III bankruptcy court can constitutionally confirm a plan containing a nonconsensual third-party release.[65] It is fascinating that the constitutional issue remained largely dormant over the following years. Given the high degree of interest in *Millennium*, this somnolence is not likely to continue. We should expect this issue to be litigated in other cases pending in courts where controlling precedent follows the majority rule—i.e., the Bankruptcy Code authorizes

confirmation of a chapter 11 plan containing a third-party release if certain stringent tests are met. These disputes will arise in a proceeding that is at the very heart of bankruptcy jurisdiction—confirmation of a chapter 11 plan—and will involve matters purely of bankruptcy law with no common law corollary.

Although we all should be hesitant to express certainty about anything involving the application of Article III to bankruptcy jurisdiction, surely it must be constitutional for a bankruptcy court to decide whether to confirm such a plan.

ENDNOTES:

[1]In re Millennium Lab Holdings II, LLC, 575 B.R. 252 (Bankr. D. Del. 2017) (hereinafter the "Millennium Bankruptcy Court Decision").

[2]Ben H. Logan, A New Millennium of Article III Analysis: Which Court—a Bankruptcy Court or a District Court—Must Decide Whether to Confirm a Plan that Contains a Nonconsensual Third-Party Release? (Part I), 37 Bankr. L. Letter No. 12 (December 2017) (hereinafter, "Part I").

[3]Const. Art. III § 1.

[4]*Comparatively* straightforward.

[5]1 Collier on Bankruptcy ¶ 3.02[3][a] at 3-30 to 3-31 (16th ed., 2017, Alan N. Resnick and Henry J. Sommer, eds.).

[6]Northern Pipeline Const. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 90, 102 S. Ct. 2858, 73 L. Ed. 2d 598, 6 Collier Bankr. Cas. 2d (MB) 785, Bankr. L. Rep. (CCH) P 68698 (1982) (Rehnquist, J., concurring).

[7]The Court explored this history and explained its relevance to current practice in Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 109 S. Ct. 2782, 106 L. Ed. 2d 26, 19 Bankr. Ct. Dec. (CRR) 493, 20 Collier Bankr. Cas. 2d (MB) 1216, Bankr. L. Rep. (CCH) P 72855, 18 Fed. R. Serv. 3d 435 (1989) (hereinafter, "Granfinanciera"). "Prior to passage of the Bankruptcy Reform Act of 1978, . . . '[s]uits to recover preferences constitute[d] no part of the proceedings in bankruptcy.' [quoting Schoenthal v. Irving Trust Co., 287 U.S. 92, 94-95, 53 S. Ct. 50, 77 L. Ed. 185 (1932).] Although related to bankruptcy proceedings, fraudulent conveyance and preference actions brought by a trustee in bankruptcy were deemed separate, plenary suits. . ." 492 U.S. at 50. This structure is carried over today in the requirement that fraudulent conveyance and preference actions be brought as separate litigations requiring the filing of a complaint with a plaintiff and defendant, service of a summons on the defendant, an opportunity for the defendant to file an answer or other dispositive pleading and essentially all of the other procedures set forth in the Federal Rules of Civil Procedure, as opposed to the omnibus procedures required for matters that are part of the main bankruptcy case. See, e.g., Fed. Rules of Bankr. Pro. 7001, et. seq. Thus, in Granfinanciera, the Court explained that under the current Bankruptcy Code, "[t]here can be little doubt that fraudulent conveyance actions by bankruptcy trustees—suits which, we said in Schoenthal v. Irving Trust Co., 287 U.S. at 94-93 (citations omitted), 'constituted no part of the proceedings in bankruptcy but concern controversies arising out of it'—are quintessentially suits at common law . . . brought by a bankruptcy corporation to augment the bankruptcy estate. . ." 492 U.S. 33, 49-50. The Court returned to this point in Executive Benefits Ins. Agency v. Arkison, 134 S. Ct. 2165, 2170, 189 L. Ed. 2d 83, 59 Bankr. Ct. Dec. (CRR) 160, 71 Collier Bankr. Cas. 2d (MB) 875, Bankr. L. Rep. (CCH) P 82642 (2014) ("Proceedings to augment the bankruptcy estate, on the other hand, implicated the district court's plenary jurisdiction and were not referred to the bankruptcy courts absent both parties' consent.")

[8]In Stern v. Marshall, the Court explained that "matters 'of private right' involve "liability of one individual to another under the law as defined." Stern v. Marshall, 564 U.S. 462, 489, 131 S. Ct. 2594, 180 L. Ed. 2d 475, 55 Bankr. Ct. Dec. (CRR) 1, 65 Collier Bankr. Cas. 2d (MB) 827, Bankr. L. Rep. (CCH) P 82032 (2011) (quoting Crowell v. Benson, 285 U.S. 22, 50, 51, 52, 52 S. Ct. 285, 76 L. Ed. 598, 1932 A.M.C. 355 (1932).

[9]See, e.g., Stern v. Marshall, supra note 8, 564 U.S. at 496 (the claim at issue was "one at common law that simply attempts to augment the bankruptcy estate—the very type of claim that we held in Northern Pipeline and Granfinanciera must be decided by an Article III court.").

[10]Id. at 499 (2011) (emphasis supplied).

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[11]Id.

[12]In their struggle to interpret Stern, some courts have adopted a cramped interpretation of that case—what Judge Silverstein calls the "Narrow Interpretation" of Stern. For example, Judge Silverstein reports that some courts that follow this "Narrow Interpretation" of Stern have gone so far as to restrict Stern to "state law counterclaims." Millennium Bankruptcy Court Decision, supra note 1 at 23-26. This is largely wishful thinking based on the fact that Stern happened to involve a state law counterclaim. This approach also gives too much weight to whether the substantive issues turn on state law. If a dispute involves a matter of state law, as opposed to pure bankruptcy law, that makes it more likely that a bankruptcy court cannot determine it (without consent). But the fact that the issue involves state law is not dispositive. In the course of dealing with matters that are central to the administration of a bankruptcy proceeding, bankruptcy judges frequently (and constitutionally) decide issues of state law. Justice Scalia made this point in his concurrence in Stern v. Marshall, supra note 8, 564 U.S. at 504. And on that point he got agreement from Justice Breyer in dissent. Id. at 513-514. Indeed, this flows from the well-known rule established in Butner v. U.S., 440 U.S. 48, 99 S. Ct. 914, 59 L. Ed. 2d 136, 19 C.B.C. 481, Bankr. L. Rep. (CCH) P 67046 (1979), that bankruptcy courts will look to non-bankruptcy law with respect to property rights (unless a federal interest, generally set forth in substantive bankruptcy law, requires a different result.). Id. at 54 ("Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law."). Examples include the validity of claims asserted against the estate, the validity and perfection of liens, and the nature of the estate's property rights, among others. This is a side note, since Judge Silverstein concluded that she did not need to rely on this so-called "Narrow View" of Stern. Millennium Bankruptcy Court Decision, supra note 1 at 28.

[13]Katchen v. Landy, 382 U.S. 323, 86 S. Ct. 467, 15 L. Ed. 2d 391, 9 Fed. R. Serv. 2d 38A.2, Case 6 (1966).

[14]Supra note 7.

[15]Langenkamp v. Culp, 498 U.S. 42, 111 S. Ct. 330, 112 L. Ed. 2d 343, 20 Bankr. Ct. Dec. (CRR) 1953, 23 Collier Bankr. Cas. 2d (MB) 973, Bankr. L. Rep. (CCH) P 73668, 18 Fed. R. Serv. 3d 586 (1990).

[16]Sections 547 and 548 of the Bankruptcy Code and §§ 60, 67 and 70 of the 1898 Act.

[17]Granfinanciera, supra note 7, 492 U.S. at 56.

[18]Id. at 58.

[19]Id. at 53 (emphasis in original).

[20]Executive Benefits Ins. Agency v. Arkison, 134 S. Ct. 2165, 189 L. Ed. 2d 83, 59 Bankr. Ct. Dec. (CRR) 160, 71 Collier Bankr. Cas. 2d (MB) 875, Bankr. L. Rep. (CCH) P 82642 (2014).

[21]Id. at 2172, 2174. There remains some room for debate, particularly when the fraudulent conveyance action seeks to avoid a lien or other transfer rather than to recover money damages. But generally speaking, the Justices seem to have accepted the premise that a fraudulent conveyance action to recover money damages cannot be decided by a bankruptcy court (without consent) unless deciding the fraudulent conveyance action is necessary to deciding whether to allow a claim that the defendant filed in the bankruptcy case. For example, during oral argument in Wellness, Justice Sotomayor expressed her view that "we've already held that a fraudulent conveyance claim against a noncreditor is an Article III violation, is a Stern claim, essentially." Tr. of oral argument in Wellness v. Sharif, January 14, 2015 at 4.

[22]18 How. 272, 284 (1856) (emphasis supplied).

[23]Id.

[24]See, e.g., Crowell v. Benson, 285 U.S. 22, 49, 52 S. Ct. 285, 76 L. Ed. 598, 1932 A.M.C. 355 (1932).

[25]See, e.g., Northern Pipeline Construction Co. v. Marathon Pipeline Co, supra note 6, 458 U.S. at 70 (Brennan, J. plurality) and 458 U.S. at 90-91 (Rehnquist, J., concurrence); Stern v. Marshall, supra note 8, 564 U.S. at 484 (2011); Wellness Intern. Network, Ltd. v. Sharif, 135 S. Ct. 1932, 1938, 191 L. Ed. 2d 911, 61 Bankr. Ct. Dec. (CRR) 32, 73 C.B.C. 1575, Bankr. L. Rep. (CCH) P 82806 (2015). Professor Brubaker characterizes this oft-repeated quotation from Murray's Lessee "as a prominent hallmark" of the Court's jurisprudence used to determine whether the Constitution requires adjudication by an Article III judge without consent. Ralph Brubaker, "Non-Article III Adjudication: Bankruptcy and Nonbankruptcy, With and Without Litigant Consent," 33 Emory

Bankr. Dev. J. 11, 38 n.22 (2016) (hereinafter, "Non-Article III Adjudication").

[26]Stern v. Marshall, supra note 8, 564 U.S. at 484 (emphasis supplied) (quoting from Justice Rehnquist's concurring opinion in Marathon).

[27]Morgan v. Thornhill, 78 U.S. 65, 20 L. Ed. 60, 80, 1870 WL 12857 (1870) (emphasis supplied); Brubaker, "Non-Article III Adjudication," supra note 25 at 57.

[28]See note 27 supra.

[29]Supra note 6, 458 U.S. at 71 (quoting Crowell v. Benson, 285 U.S. 22, 51, 52 S. Ct. 285, 76 L. Ed. 598, 1932 A.M.C. 355 (1932)).

[30]For example, in Granfinanciera, the Court stated that "[w]e do not "suggest that the restructuring of debtor-creditor relations is in fact a public right. This thesis has met with substantial scholarly criticism [citations omitted] and we need not and do not seek to defend it here." Supra note 7, 492 U.S. at 56 n.11. In Stern v. Marshall, the majority opinion quoted this passage from Granfinanciera and indicated that since no party had asked it to "reconsider the public rights framework for bankruptcy" it was not going to do so in Stern. Supra note 8, 546 U.S. at 492 n.7. In his concurrence in Stern, Justice Scalia persisted in his view that the "public rights" doctrine is inapplicable to bankruptcy. Id. at 503. Professor Brubaker explores this topic in substantial depth in his most recent article on Article III. Brubaker, Non-Article III Adjudication, supra note 25 at 41-52. As he explains, a "majority of the Court . . . has never embraced the proposition that non-Article III adjudications are 'public rights' adjudications. A majority of the Court, however, has expressly and repeatedly questioned whether the 'public rights' doctrine has any purchase at all in the bankruptcy context." Id. at 42 (emphasis in original).

[31]For example, in Granfinanciera, the Court observed that the fraudulent conveyance action there was not "integral to the restructuring of debtor-creditor relations." Supra note 7, 492 U.S. at 58.

[32]In re TCI 2 Holdings, LLC, 428 B.R. 117, 139-141 (Bankr. D. N.J. 2010); Beal Bank, S.S.B. v. U.S. Nat'l Bank Ass'n, 2010 U.S. Dist. LEXIS 5809 (S.D.N.Y. June 8, 2010); H.R. Rep. No. 95-595, 95th Cong. 1st Sess. 359 (1977); 4 Collier on Bankruptcy ¶ 510.03[3] at 510-11 to 520-12 (16th ed. 2017, Alan N. Resnick and Henry J. Sommer, eds.).

[33]Millennium Bankruptcy Court Decision, supra note 1, 575 B.R. at 275-285.

[34]See Part I, section III.A.

[35]499 B.R. 66 (Bankr. D. Mass. 2013).

[36]Id. at 98-99.

[37]Id. at 98-99.

[38]Millennium Bankruptcy Court Decision, supra note 1, 575 B.R. at 273.

[39]It has become increasingly common to refer to the bankruptcy law that preceded the passage of the Bankruptcy Code in 1978 as the Bankruptcy Act of 1898—when I first started practicing it was more commonly referred to simply as "the Act." Referring to it as the 1898 Act can be a bit misleading since when this statute was first passed in 1898 it was quite a bit different than the bankruptcy law in effect over most of the time that it was in effect. Over its 80 life, the Bankruptcy Act of 1898 underwent a number of radical changes, including the addition in the 1930's of provisions providing for corporate reorganizations—e.g., passage of § 77B in 1934, superseded by the passage of Chapters X and XI as part of the Chandler Act in 1938. So it is not correct to analyze the predecessor to the current Bankruptcy Code as though it was a monolithic statute that was constant over its life.

[40]U.S. Const. Art. III, § 1, cl. 1. Practice in 18th Century England provides context for what the Framers meant in Article III by the "judicial Power" of the United States. But otherwise the provisions of Article III are far different than 18th Century English practice. The Constitution is designed to separate powers among the three branches of the federal government, and in order to ensure the independence of the federal judiciary requires life tenure and salary protection. In contrast, at the time of the Constitution, in "Britain, the judicial power, in the last resort, resides in the House of Lords, which is a branch of the legislature." Hamilton, The Federalist Papers 81. The Constitution provides that the judiciary be established as an independent branch, "instead of being one of the branches of the legislature, as in the government of Great Britain. . ." Id. Similarly, 18th Century English practice regarding the tenure and compensation of judges was less protective than what is required in the Constitution. The Lord Chancellor was the senior judge of the Chancery courts and the Lord Chancellor served at

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the pleasure of the King. Prior to the passage of the Act of Settlement 1701, lower court judges also served at the pleasure of the King; the 1701 Settlement Act provided some measure of tenure, but even still, lower court judges could be removed by Parliament. Joseph H. Smith, "An Independent Judiciary: The Colonial Background," 124 U. Pa. L. Rev. 1104, 1105-1110 (1976); Henry Brooke, "The History of Judicial Independence in England and Wales," European Human Rights Law Review (Issue 5 2015 at 446-458). Thus, the "Framers of the Constitution 'lived among the ruins of a system of intermingled legislative and judicial powers.'. . . Under British rule, the King 'made Judges dependent on his Will alone, for the tenure of their offices, and the amount and payment of their salaries.' " Wellness, supra note 25, 135 S. Ct. at 1950. To be clear, there were many grey areas in 18th Century England, with the courts being seen as part of the legislative branch for some purposes and part of the executive branch for other purposes.

[41]Thomas E. Plank, "Why Bankruptcy Judges Need Not and Should Not Be Article III Judges," 72 Am. Bankr. L.J. 567, 576 (1998).

[42]Id. at 576. Although the commissioners were drawn from a panel of standing bankruptcy commissioners, they only had jurisdiction if and when appointed for a particular bankruptcy proceeding and then only pursuant to the terms of the Commission of Bankruptcy issued by the Lord Chancellor. Id. In that respect, bankruptcy commissioners were similar to many other commissioners used in 18th Century England to decide certain specialized matters.

[43]Id. at 577.

[44]Id. at 577-578.

[45]See, e.g., Campbell v. Alleghany Corp., 75 F.2d 947, 951 (C.C.A. 4th Cir. 1935) ("It must be remembered, however, that the power granted Congress over the subject of bankruptcies is plenary, and that in its exercise 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. Like other constitutional grants of power, that giving Congress power over bankruptcies is to be interpreted, not in the light of the conditions with which the framers of the Constitution were familiar, but of what is required under modern conditions to deal adequately with the relationship existing between embarrassed debtors and their creditors."); 6 Collier on Bankruptcy ¶ 0.10 at 109-110 (14th ed., 1977, James William Moore and Lawrence P. King, eds.).

[46]See generally, Brubaker, Non-Article Adjudication, supra note 25 at 36-90.

[47]Id. at 41.

[48]2 Collier on Bankruptcy at 431 (14th ed. 1976, James William Moore and Lawrence P. King, eds.) (emphasis supplied).

[49]Id.

[50]The version of the 1898 Act in effect at the time of its passage is available at https://catalog.hathitrust.org/Record/100471036.

[51]This history is explored in Weidhorn v. Levy, 253 U.S. 268, 272, 40 S. Ct. 534, 64 L. Ed. 898 (1920).

[52]2 Collier on Bankruptcy ¶ 23.01[4] (14th ed., 1976, James William Moore and Lawrence P. King, eds.).

[53]"[T]he referee in bankruptcy is without power to hear the issues involved in a plenary suit where timely objection is made to such determination." 2A Collier on Bankruptcy ¶ 38.09 at 1432 (14th ed., 1978, James William Moore and Lawrence P. King, eds.); see also, 6A Collier on Bankruptcy ¶ 6.04[6] at 824 (14th ed., 1978, James William Moore and Lawrence P. King, eds.).

[54]Determining these issues of actual or constructive possession bedeviled the courts that interpreted the 1898 Act, particularly as commercial practice evolved so that property was increasingly intangible and where multiple interests in the same item of property were held by different parties. As a result, "possession" was often an illusory concept. Litigation over whether a dispute involved "property within the actual or constructive possession" of a bankruptcy court was frequent, with many inconsistencies in the decisions. Thus, the 14th Edition of Collier dedicates much of its discussion of the line between summary and plenary matters to the problems inherent in determining whether the court had actual or constructive possession of the property at issue. 2 Collier on Bankruptcy at 469-532 (14th ed. 1976, James William Moore and Lawrence P. King, eds.). As one commentator observed, "as much as fifty percent of all litigation under the Act of 1898 concerned whether a matter was within the bankruptcy court's summary jurisdiction." Thomas S. Marrion, "Core Proceedings and the 'New' Bankruptcy Jurisdic-

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tion," 36 DePaul L.Rev.675, 677 (1986). In addition, there was "an excessive amount of preliminary litigation over jurisdictional issues" in which a bankruptcy court conducted a "minitrial" on the merits, attempting to apply the "murky contours" of whether a third-party's assertion of possession pursuant to an adverse interest was bona fide. Ralph Brubaker, "On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory," 41 Wm. & Mary L. Rev. 743, 792-93 (2000).

[55]6 Collier on Bankruptcy ¶ 3.05 at 421-422 (14th ed. 1978, James William Moore and Lawrence P. King, eds.) (emphasis supplied).

[56]2 Collier on Bankruptcy ¶ 23.02[2] at 439 (14th ed. 1976, James William Moore, and Lawrence P. King, eds.). The line of demarcation in current practice between contested matters and adversary proceedings provides a close, but inexact, analogy. Ralph Brubaker, "Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations," 1997 U. of Ill. L.Rev. 959, n.315 (hereinafter "A Critical Reappraisal"). It is inexact because courts are free to develop more formal means of proceeding in matters under the court's summary jurisdiction if they believe that wise. Thus, as time progressed, courts operating under the 1898 Act increasingly required more formal means of proceeding in summary matters, often incorporating relevant rules from the Federal Rules of Civil Procedure. 8 Collier on Bankruptcy ¶ 3.01[3] at 149 (14th ed., 1978, James William Moore, and Lawrence P. King, eds.). Similarly, the current bankruptcy rules require that matters related to a discharge generally be handled by an adversary proceeding (Fed. Rule of Bankr. Pro. 7001(4) and (6)) although these matters were within the summary jurisdiction of a referee and may be decided by a current bankruptcy judge (without consent).

[57]Brubaker, A Critical Reappraisal, supra note 56 at 1053.

[58]Vol. A Collier on Bankruptcy App. Pt. 3-18 (16th ed. 2017, Alan N. Resnick and Henry J. Sommer eds.) (emphasis supplied). The text of § 16 as it appeared throughout the entire time that the 1898 Act was in effect is set forth in Appendix A of the current version of Collier.

[59]Matter of Specialty Equipment Companies, Inc., 3 F.3d 1043, 29 Collier Bankr. Cas. 2d (MB) 1215, Bankr. L. Rep. (CCH) P 75398 (7th Cir. 1993).

[60]Union Carbide Corp. v. Newboles, 686 F.2d 593, 7 Collier Bankr. Cas. 2d (MB) 1, Bankr. L. Rep. (CCH) P 68790 (7th Cir. 1982).

[61]Specialty Equipment, 3 F.3d at 1046.

[62]It is also far from clear that modern courts that follow the majority view would conclude that the language in § 16 of the 1898 Act precluded a plan from providing for a third-party release, as opposed to merely stating that a discharge, standing alone, does not release a third-party claim. See Part I, section III.B.1. The key point is that these issues involve an interpretation of the substantive provisions of bankruptcy law rather than which court must decide these issues.

[63]Stoll v. Gottlieb, 305 U.S. 165, 59 S. Ct. 134, 83 L. Ed. 104 (1938). See Part I, section III.A.

[64]Brubaker, A Critical Reappraisal, supra note 56 at n. 352.

[65]In re Continental Airlines, 203 F.3d 203, n. 12, 35 Bankr. Ct. Dec. (CRR) 176 (3d Cir. 2000) ("We also note, with some concern, that the Bankruptcy Court apparently never examined its jurisdiction to release and permanently enjoin Plaintiffs' claims against non-debtors. Although bankruptcy subject matter jurisdiction can extend to matters between non-debtor third-parties affecting the debtor or the bankruptcy case [citations omitted], a court cannot simply presume it has jurisdiction in a bankruptcy case to permanently enjoin third-party class actions against non-debtors. We must remain mindful that bankruptcy jurisdiction is limited, as is the explicit grant of authority to bankruptcy courts. [Citing the Judicial Code and Marathon]. We do not treat this very significant issue more fully, however, because the record does not permit us to resolve this issue and the parties have not raised and discussed it in their appellate briefs.").

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A Case Study in Federal Bankruptcy Jurisdiction: Core Jurisdiction (or Not) to Approve Non-Debtor "Releases" and Permanent Injunctions in Chapter 11

By Ralph Brubaker

In a two-part article in the previous two issues of *Bankruptcy Law Letter,*[1] my friend Ben Logan has put forth a considerable effort to bolster the bankruptcy court's recent decision in the *Millennium Lab* case.[2] That decision held that non-Article III bankruptcy courts can enter final orders (i) approving nonconsensual plan of reorganization provisions and (ii) issuing implementing injunctions (together, known by the euphemism *non-debtor "releases"*) that permanently extinguish and bar nonconsenting creditors from pursuing direct claims of liability against non-debtor parties. In *Millennium Lab*, for example, the non-debtor "release," approved by final order of the bankruptcy court, extinguished any and all claims the debtor's creditors might have against, inter alia, the debtor's officers, directors, and corporate parents, including fraud and RICO claims asserted in a federal district-court lawsuit by certain of the debtor's prepetition lenders against both of the debtor's corporate parents and two of the debtor's individual corporate officers, one of whom was the debtor's founder.

Millennium Lab was wrongly decided. It is unconstitutional for a non-Article III

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[1]Ben H. Logan, A New *Millennium* of Article III Analysis: Which Court—a Bankruptcy Court or a District Court—Must Decide Whether to Confirm a Plan that Contains a Nonconsensual Third-Party Release? (Part I), 37 Bankr. L. Letter No. 12, at 1 (Dec. 2017); Ben H. Logan, A New *Millennium* of Article III Analysis: Which Court—a Bankruptcy Court or a District Court—Must Decide Whether to Confirm a Plan that Contains a Nonconsensual Third-Party Release? (Part II), 38 Bankr. L. Letter No. 1, at 1 (Jan. 2018).

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bankruptcy court to enter such a final judgment, and Logan's analysis ultimately is misguided in several (and quite fundamental) ways, as I hope to make clear in this article. Most critically, Logan (and the *Millennium Lab* opinion) misperceive the applicable jurisdictional unit at issue when a judge is asked to approve a non-debtor "release." The relevant litigation unit, for purposes of jurisdictional analysis, is *not* the plan confirmation "proceeding." The jurisdictional unit over which the judge must exercise jurisdiction in order to approve a non-debtor "release" is each individual jurisdictional "claim" of a creditor against a non-debtor that is sought to be extinguished via nonconsensual "release" thereof. Because Logan and *Millennium Lab* focus on the wrong jurisdictional unit, their entire jurisdictional analysis is flawed.

Logan is quite right, though, to emphasize the importance of this particular jurisdictional issue that has now conspicuously surfaced in the wake of the Supreme Court's *Stern v. Marshall* decision.[3] As Logan points out, the constitutionality of a non-Article III bankruptcy judge entering final judgment approving a non-debtor "release" was seriously questioned long before the *Stern* decision (as were other jurisdictional difficulties now being "discovered" post-*Stern*). Indeed, I wrote (at some length) about precisely the problem at issue in *Millennium Lab* when I was a young assistant professor, in an article published 20 years ago, in which I observed that "[p]erhaps the most complicated and confusing aspect of the controversy surrounding nondebtor releases and injunctions is the preliminary inquiry for any exercise of judicial power—jurisdiction."[4] And my quest to understand the difficult, but fascinating jurisdictional

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[2]In re Millennium Lab Holdings II, LLC, 575 B.R. 252 (Bankr. D. Del. 2017).

[3]Stern v. Marshall, 564 U.S. 462 (2011).

[4]Ralph Brubaker, Nondebtor Releases and Injunctions in Chapter 11: Revisiting Jurisdictional Precepts and the Forgotten *Callaway v. Benton* Case, 72 Am. Bankr. L.J. 1, 13

implications of non-debtor "releases" is what sparked my abiding and more general interest in federal bankruptcy jurisdiction and procedure as a field worthy of sustained scholarly inquiry, pursuit of which has now occupied a large part of my academic career.

Subsequent maturation of the Supreme Court's governing jurisprudence (and, hopefully, my own understanding thereof) has not changed my views regarding the basic constitutional impediment to a non-Article III bankruptcy court issuing a final judgment approving a non-debtor "release." The essential contours of the problem remain unchanged by *Stern*, *Arkison*,[5] and *Wellness*.[6] Understanding why such an order is unconstitutional, though, requires a solid foundation in a wide range of first principles of federal bankruptcy jurisdiction and general federal courts law—a virtual whirlwind tour of my upper-level law-school course in Bankruptcy Procedure.[7]

(1998), available at https://ssrn.com/abstract=2176443.

[5]Exec. Benefits Ins. Agency v. Arkison, 134 S. Ct. 2165 (2014).

[6]Wellness Int'l Network, Ltd. v. Sharif, 135 S. Ct. 1932 (2015).

[7]Like Logan, I will confine my analysis to the jurisdictional issues implicated by non-debtor "releases" and, thus, will assume *arguendo* that the Bankruptcy Code does authorize confirmation of a plan of reorganization containing nonconsensual non-debtor "release" provisions. I do not believe that is true, though, and my views in that regard are set forth in Ralph Brubaker, Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations, 1997 U. Ill. L. Rev. 959, available at https://ssrn.com/abstract=2176436. That conclusion is further buttressed by the Supreme Court's subsequent decisions regarding the limitations of courts' general equitable powers in bankruptcy cases and particularly the analytical structure of the Court's opinion in *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017). See generally Ralph Brubaker, Taking Bankruptcy's Distribution Rules Seriously: How the Supreme Court Saved Bankruptcy From Self-Destruction, 37 Bankr. L. Letter No. 4, at 1 (Apr. 2017).

Courts that come to the same conclusion—that nothing in the bankruptcy statute or courts' general equitable powers authorizes nonconsensual non-debtor "releases"—have often used the terminology that the court is "without jurisdiction" or lacks "subject matter jurisdiction" to approve such a non-debtor "release." See, e.g., In re Johns-Manville Corp., 517 F.3d 52, 66-67 (2d Cir. 2008), rev'd on other grounds sub nom., Travelers Indemn. Co. v. Bailey, 557 U.S. 137 (2009). See generally Ralph Brubaker, Supreme Court Validates

Subject Matter Jurisdiction Versus the Adjudicatory Authority of Non-Article III Judicial Officers

Federal bankruptcy jurisdiction, in general, and non-debtor "releases," in particular, implicate two easily confused and conflated, but very different kinds of "jurisdictional" issues, each of which has both a constitutional and a statutory dimension. One kind of jurisdictional issue is typically referred to as determining the existence of *federal subject matter jurisdiction*, a necessary and preliminary requisite for any dispute to be addressed by a federal court. For there to be federal subject matter jurisdiction over a particular matter, (1) it must be one that is within the carefully limited kinds of "cases and controversies" properly the subject of federal jurisdiction, as delineated in Article III, § 2 of the Constitution, and (2) Congress must have vested the federal courts with subject matter jurisdiction to decide such a matter by a duly enacted jurisdictional statute. The scope of federal subject matter jurisdiction (limited by both the Constitution and the terms of federal jurisdiction statutes) implicates *judicial federalism* concerns regarding the appropriate allocation of judicial power as between the federal courts and the state courts. What disputes can we essentially take from the state courts and place before the federal courts through federal bankruptcy jurisdiction?[8]

"Clarified" *Manville* Insurance Injunction: Channeling … and So Much More!, 29 Bankr. L. Letter No. 8, at 1, 1-5, 7-9 (Aug. 2009). That use of the terminology of "jurisdiction" (meaning, literally, power) is not improper, but it is a bit confusing because it obviously is referring to a different (and more absolute) kind of "jurisdictional" limitation than those implicated (and discussed in this article) when one assumes that the statute does authorize non-debtor "releases."

[8]For a comprehensive background in the constitutional and statutory issues implicated by the grant of federal subject-matter jurisdiction over bankruptcy cases and proceedings, see Ralph Brubaker, On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory, 41 Wm. & Mary L. Rev. 743 (2000), available at https://ssrn.com/abstract=2175208. For a concise introduction to the topic, see Ralph Brubaker,

Non-debtor releases do (as we'll see) inevitably implicate subject-matter jurisdiction constraints regarding the outermost limits of federal bankruptcy jurisdiction (over what the statute designates "related to" proceedings). That was not, however, the primary jurisdictional issue addressed in the *Millennium Lab* opinion and Logan's assiduous defense thereof. Rather, *Millennium Lab* concerned the *Marathon* and *Stern* jurisdictional issue of the proper allocation of federal bankruptcy jurisdiction as between Article III and non-Article III tribunals, necessitated by constitutional limitations on the adjudicatory powers of non-Article III bankruptcy judges.

The *Marathon/Stern* limitations are a product of Article III, § 1's protection of *separation-of-powers* and *judicial independence* values, through its guarantee that the federal "judicial Power" will be exercised only by judges with life tenure and irreducible compensation. Because bankruptcy judges do not enjoy these Article III protections, their adjudicatory authority is necessarily limited. Thus, for matters within Congress's grant of bankruptcy jurisdiction to the federal courts (i.e, within federal subject matter jurisdiction over bankruptcy matters), there is a complex allocation of adjudicatory powers as between the Article III district courts and their non-Article III bankruptcy courts (that are a unit of the district court in each district).

This division of adjudicatory authority is reflected in the statutory structure that empowers bankruptcy judges to enter final judgment only (1) in what the statute now denominates "core" proceedings, involving matters within the traditional "summary" jurisdiction

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One Hundred Years of Federal Bankruptcy Law and Still Clinging to an *In Rem* Model of Bankruptcy Jurisdiction, 15 Emory Bankr. Dev. J. 261 (1999), available at https://ssrn.com/abstract=2176482.

of specialized bankruptcy tribunals, or (2) with consent of the litigants, in other matters within the scope of federal bankruptcy jurisdiction. For matters *not* within bankruptcy judges' core/summary jurisdiction—traditionally the subject of a so-called "plenary" suit in a superior court of law or equity—the litigants have an inviolate constitutional right to final judgment from an Article III judge. The jurisdictional statute authorizes bankruptcy judges to "hear" such a non-core "related to" matter, but final judgment must be from an Article III district judge after a *de novo* review.[9] The issue in *Millennium Lab* (still *sub judice*, currently on appeal) is whether approval of a nonconsensual non-debtor "release" is such a non-core/plenary matter.

Confirmation of a Plan of Reorganization or Final Adjudication of Third-Party Non-Debtor Claims?

In resolving that issue—whether approval of a nonconsensual non-debtor "release" is a non-core/plenary matter in which a party thereto has an inviolable constitutional right to final judgment from an Article III judge—Logan is also correct in identifying the central bone of contention that is completely determinative: What, exactly, is a judge exercising jurisdiction over when that judge enters a final judgment approving a nonconsensual non-debtor "release"? There are two alternative, competing conceptions of what that judge is exercising jurisdiction

[9]For a comprehensive background in the constitutional and statutory issues implicated by the *Marathon*/*Stern* limitations on the jurisdiction of non-Article III bankruptcy judges, see Ralph Brubaker, A "Summary" Statutory and Constitutional Theory of Bankruptcy Judges' Core Jurisdiction After *Stern v. Marshall*, 86 Am. Bankr. L.J. 121 (2012), available at https://ssrn.com/abstract=2174645, and Ralph Brubaker, Non-Article III Adjudication: Bankruptcy and Non-Bankruptcy, With and Without Litigant Consent, 33 Emory Bankr. Dev. J. 11 (2016), available at https://ssrn.com/abstract=2980872.

over: (1) confirmation of a plan of reorganization, or (2) final adjudication of creditors' claims against a non-debtor.

Non-Article III Bankruptcy Judges Have Core/Summary Jurisdiction to Confirm a Plan of Reorganization

The conception of Logan (and the bankruptcy court in *Millennium Lab*) is that when a judge enters final judgment approving a nonconsensual non-debtor "release," the matter or "proceeding" over which the judge is exercising jurisdiction is confirmation of a plan of reorganization. And that is the case, so the argument goes, since approval of a non-debtor "release" is only done in conjunction with confirmation of a plan of reorganization, after the judge finds that inclusion of the non-debtor "release" is appropriate under federal bankruptcy law standards. Thus, approval of the non-debtor "release" is part and parcel of confirmation of the plan itself. As the *Millennium Lab* bankruptcy court stated, "[i]n this matter, the operative proceeding for purposes of a constitutional analysis is confirmation of a plan."[10]

If that is the appropriate conception of the matter or "proceeding" over which the judge is exercising jurisdiction, then Logan is right that *Millennium Lab* was correctly decided. Regardless of one's interpretation of the Supreme Court's cumulative jurisprudence regarding the appropriate test or theory or analysis for determining the kinds of matters that a non-Article III bankruptcy judge can constitutionally determine by final order or judgment,[11] confirmation of

[10]Millennium Lab, 575 B.R. at 271.

[11]The only qualifying proviso to append is that existing Supreme Court precedent leaves open the possibility that the Court might ultimately conclude that bankruptcy judges simply cannot enter final orders and judgments on any matter within the scope of federal bankruptcy

a plan of reorganization indisputably *is* one of those core, traditionally summary matters.[12] That, however, is *not* an appropriate conception of the matter over which the judge is exercising jurisdiction when entering a final judgment approving a nonconsensual non-debtor "release."

Specifying the Applicable Jurisdictional Unit

Because the subject matter jurisdiction of all federal courts is limited, as is the jurisdiction of any non-Article III tribunal, either kind of "jurisdictional analysis requires a conception of the fundamental unit of litigation" so that matters within that limited jurisdiction can be distinguished from matters that are not.[13] And the fundamental unit of litigation for purposes of jurisdictional analysis is an individual "claim."

Whether the jurisdictional statute speaks in terms of jurisdiction over a "civil action" (as does, e.g., the general federal question statute[14] and the diversity statute[15]) or a "proceeding" (as does the bankruptcy jurisdiction statute[16]), "[o]riginal jurisdiction attaches on a claim-by-claim

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jurisdiction and, thus, the entirety of bankruptcy judges' statutory core jurisdiction is unconstitutional. That possibility is consistent with a credible constitutional theory and seemed plausible (even if not probable) after the *Stern* decision. See Brubaker, 86 Am. Bankr. L.J. at 174-76. It seems highly unlikely after *Wellness*, though, because "a majority of the Justices—the *Stern* dissenters (Breyer, Ginsburg, Sotomayor, and Kagan) and the *Wellness* dissenters (Roberts, Scalia, and Thomas)—have now indicated their belief that the bulk of bankruptcy judges' core jurisdiction is indeed constitutionally valid." Brubaker, 33 Emory Bankr. Dev. J. at 39.

[12]See 6 Collier on Bankruptcy ¶ 3.05, at 421-22 (James Wm. Moore et al. eds., 14th ed. 1978).

[13]American Law Institute, Federal Judicial Code Revision Project 47 (2004) [hereinafter ALI, Judicial Code Project].

[14]28 U.S.C. § 1331.

[15]28 U.S.C. § 1332(a).

[16]28 U.S.C. §§ 1334(b), 157(a). "The federal 'judicial power' in bankruptcy … is and always has been exercised through various bankruptcy 'proceedings' connected with a particular debtor's bankruptcy case," and "a bankruptcy 'proceeding' within the meaning of the bankruptcy

or 'claim-specific' basis."[17] Indeed, "the original jurisdiction of the district courts is claim-specific in a pervasive and fundamental sense that pertains to the entire statutory and constitutional structure of federal subject matter jurisdiction."[18] And the Third Circuit has also expressly adopted such "a claim by claim analysis to determine the extent of a Bankruptcy Court's [core] jurisdiction."[19]

For purposes of jurisdictional analysis, an individual "claim"—over which a federal court either does or does not have jurisdiction—is "an assertion by one claiming party of a right to some form of judicial relief" against another party.[20] One jurisdictional "claim," therefore, "is defined in terms *both* of a particular pair of parties" to that one "claim" for relief *and* the particular legal right or obligation being asserted between those two parties.[21] Just as a nonbankruptcy "civil action" in a federal district court may be comprised of multiple claims

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jurisdiction statute is the equivalent of a nonbankruptcy 'case,' 'civil action,' or 'suit.'" Ralph Brubaker, Of State Sovereign Immunity and Prospective Remedies: The Bankruptcy Discharge as Statutory *Ex parte Young* Relief, 76 Am. Bankr. L.J. 461, 540 (2002) (footnotes omitted), available at https://ssrn.com/abstract=2176482. See Conn. Nat'l. Bank v. Germain, 503 U.S. 249 (1992) (holding that a court of appeals may entertain an interlocutory appeal in a bankruptcy "proceeding" pursuant to the general interlocutory appeals provision, governing an appeal in a "civil action"); cf. Things Remembered, Inc. v. Petrarca, 516 U.S. 124, 129 (1995) (opining that the general Judicial Code provisions for removal and remand of "civil actions" and "cases" can "comfortably coexist" with the bankruptcy removal and remand provisions).

[17]ALI, Judicial Code Project, at 16.

[18]ALI, Judicial Code Project, at 42. See John B. Oakley, The *Christianson* Case, Federal Jurisdiction, and the Problem of the Litigative Unit: When Does What "Arise Under" Federal Law?, 76 Tex. L. Rev. 1829, 1831-32, 1858-59 (1998); John B. Oakley, Integrating Supplemental Jurisdiction and Diversity Jurisdiction: A Progress Report on the Work of the American Law Institute, 74 Ind. L.J. 25 (1998).

[19]Halper v. Halper, 164 F.3d 830, 838-39 (3d Cir. 1999). See also In re Exide Technologies, 544 F.3d 196, 206, 218-21 (3d Cir. 2008). Accord Waldman v. Stone, 698 F.3d 910, 921 (6th Cir. 2012); Dunmore v. U.S., 358 F.3d 1107, 1114 (9th Cir. 2004).

[20]ALI, Judicial Code Project, at 30.

[21]ALI, Judicial Code Project, at 30 (emphasis added).

being asserted between two (or more) parties (each of which must be within the subject matter jurisdiction of the court), the same is true of any given "proceeding" within the bankruptcy jurisdiction of a federal district court and referred to the bankruptcy court (under a standing order of reference).[22] And this is especially true for a plan confirmation "proceeding," precisely because (as Logan points out) it is "a unitary omnibus civil proceeding for the reorganization of *all* obligations of the debtor and disposition of *all* its assets."[23] All of a debtor's creditors, therefore, against whom various forms of judicial relief is sought (including discharge of each of their claims against the debtor), are parties to a plan confirmation proceeding.[24] Consequently, a court may exercise jurisdiction over hundreds and even thousands of jurisdictional "claims" in confirming a plan of reorganization.

Individual analysis of each and every jurisdictional "claim" in a plan confirmation proceeding is rarely necessary because the traditional "claims" at issue in plan confirmation are ones (1) that are clearly within the federal subject-matter grant of bankruptcy jurisdiction, and (2) on which a non-Article III bankruptcy judge can clearly enter a final order as a conventional core/summary matter: various "claims" regarding "the reorganization or adjustment of all

[22]By contrast, the litigation unit for final-order appellate jurisdiction is an entire "civil action" or "proceeding" and all jurisdictional "claims" asserted therein. Appeals of individual "claims" before final resolution of an entire "civil action" or "proceeding" can be taken only via interlocutory appeal. See generally Ralph Brubaker, Bankruptcy Appeals: Finality and the Appellate Litigation Unit, 35 Bankr. L. Letter No. 6, at 1 (June 2015).

[23]In re Charles Street African Methodist Episcopal Church of Boston, 499 B.R. 66, 99 (Bankr. D. Mass. 2013) (emphasis added).

[24]11 U.S.C. § 1141(a) ("the provisions of a confirmed plan bind … any creditor [or] equity security holder … in the debtor"). See Sanders Confectionary Prods, Inc. v. Heller Fin., Inc., 973 F.2d 474, 481 (6th Cir. 1992) (all "creditors and equity security holders in the debtor[] must … be considered parties" to the plan confirmation proceeding); In re Justice Oaks II, Ltd., 898 F.2d 1544, 1551 & n.5 (5th Cir. 1990) ("[a]ll creditors of a debtor are parties in interest"

obligations of *the debtor* and disposition of all *the debtor's* assets."[25]

Non-debtor "releases," though, bring jurisdictional "claims" (asserting a right to relief between two *non-debtor* parties) into the confirmation "proceeding," which jurisdictional "claims" are *not* so clearly within (1) the federal grant of subject-matter jurisdiction in bankruptcy or (2) the conventional core/summary jurisdiction of a non-Article III bankruptcy judge. Indeed, in its *Continental Airlines* decision, the Third Circuit noted, "with some concern," regarding a bankruptcy court's "jurisdiction to release and permanently enjoin [creditor]s' claims against non-debtors":

> Although bankruptcy subject matter jurisdiction can extend to matters between non-debtor third parties affecting the debtor or the bankruptcy case [through the grant in § 1334(b) of the Judicial Code of original jurisdiction over proceedings "related to" a bankruptcy case], a court cannot simply presume it has jurisdiction in a bankruptcy case to ["release" and] permanently enjoin third-party … actions against non-debtors. We must remain mindful that bankruptcy jurisdiction is limited, as is the explicit grant of authority to bankruptcy courts.[26]

The jurisdictional analysis required for approval of a non-debtor release by a bankruptcy judge, therefore, must address both (1) the subject matter jurisdiction of a federal court to approve a jurisdictional "claim" requesting approval of a nonconsensual non-debtor "release,"

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who are "obviously parties to the confirmation proceeding")..

[25]Charles Street, 499 B.R. at 99 (emphasis added).

and (2) assuming the existence of federal subject matter jurisdiction, whether it is constitutional for a non-Article III bankruptcy court to issue a final judgment approving that "release."

"Related To" Subject Matter Jurisdiction Over "Released" Third-Party Claims

In analyzing a federal court's subject matter jurisdiction in bankruptcy to approve a non-consensual non-debtor "release" as applied to the relevant litigation unit, a jurisdictional "claim," consider a typical individual claim extinguished by a nonconsensual non-debtor "release" provision: one creditor's (C's) alleged right to recover damages from one individual "released" non-debtor (ND, who is a shareholder and President of the debtor corporation, D) alleged to have committed common-law fraud in inducing C to lend money to D. As Logan points out, if "extinction of"[27] that fraud claim by a federal court is authorized at all, it can only be by virtue of some federal bankruptcy law authorizing extinguishment of C's fraud claim against ND. Since the right to extinguish that fraud claim, if it exists, is grounded in federal law, one might be tempted, therefore, to conclude that federal subject-matter jurisdiction over the jurisdictional "claim" at issue (seeking extinguishment of C's fraud claim against ND) is easily established as a conventional constitutional[28] and statutory[29] federal-question claim "arising under" the

[26]In re Continental Airlines, 203 F.3d 203, 214 n.12 (3d Cir. 2000).

[27]This is the phrase used by the Supreme Court in *Stoll v. Gottlieb* to describe the relief granted by a final judgment confirming a plan of reorganization containing what is now popularly known as a nonconsensual non-debtor "release" provision. 305 U.S. 165, 168-69 (1938).

[28]U.S. Const. art III, § 2, cl. 1 (authorizing Congress to grant federal courts jurisdiction over claims "arising under" federal law).

[29]28 U.S.C. § 1334(b) (granting the federal district courts original jurisdiction over claims "arising under" the Bankruptcy Code).

provisions of federal law, to wit, the Bankruptcy Code.[30] The matter is not so simple, though.

There is no provision in the Bankruptcy Code explicitly authorizing extinguishment of C's fraud claim against ND. Indeed, until the Fourth Circuit's 1989 decision in the A.H. Robins reorganization,[31] "it was virtually unthinkable … that a bankruptcy court could enter an order discharging the *in personam* liability of a nondebtor party to a debtor's creditors."[32] Thus, (as Logan also acknowledges) to extinguish C's fraud claim against ND, a bankruptcy court must rely upon the grant of authority in Bankruptcy Code § 105(a) to issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions of" general Code sections regarding plan confirmation and implementation. "Section 105, however, is not an independent source of jurisdiction, a notion that § 105(c) now makes explicit."[33] By virtue of Code § 105(c), therefore, a "claim" seeking an order issued under § 105(a) does not "arise under" the Bankruptcy Code for jurisdictional purposes, simply by virtue of the fact that Code § 105(a) codifies general equitable powers. And the fact that the courts have fashioned federal standards for the circumstances under which it is appropriate to approve a nonconsual non-debtor "release" is also insufficient to make the request therefor a jurisdictional claim "arising under" the Bankruptcy Code, within the meaning of the bankruptcy jurisdiction statute (Judicial Code §

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[30] See Brubaker, 41 Wm. & Mary L. Rev. at 801.

[31] In re A.H. Robins Co., 880 F.2d 694, 700-02 (4th Cir. 1989).

[32] Brubaker, 29 Bankr. L. Letter No. 8, at 7-8. Logan's suggestions to the contrary mischaracterize the state of the law before *Robins*. The only example he cites to the contrary, *Stoll v. Gottlieb*, was a preclusion case in which the Supreme Court assumed that the federal bankruptcy statute did *not* authorize extinguishing the creditor's claim against the non-debtor and, thus, that "the Bankruptcy Court did *not* have jurisdiction of the subject matter of the order" extinguishing that claim. 305 U.S. at 171 (emphasis added).

[33] Brubaker, 72 Am. Bankr. L.J. at 13.

1334(b)).[34]

If there is no statutory grant of federal subject matter jurisdiction in that portion of the bankruptcy jurisdiction statute providing for jurisdiction over claims "arising under" the Bankruptcy Code, then what is the source of subject matter jurisdiction over the jurisdictional "claim" requesting extinguishment of C's fraud claim against ND? As the courts have recognized, the only jurisdictional grant that could reach such a third-party claim (to finally adjudicate the *in personam* rights of a creditor against a non-debtor) is the statutory provision for federal jurisdiction over claims "related to" a bankruptcy case.[35] In fact, a third-party claim "between nondebtors which [may] have an effect on the bankruptcy estate" is a standard example of "related to" bankruptcy jurisdiction.[36]

Thus, in vacating a nonconsensual non-debtor "release" issued on the authority of Code § 105(a), the Third Circuit appropriately framed the subject-matter jurisdiction inquiry as follows: "At issue is whether the District Court [which issued the final order confirming the plan in that

[34]See In re Combustion Engineering, Inc., 391 F.3d 190, 224-25 (3d Cir. 2004). Logan seems to admit as much. Logan, 37 Bankr. L. Letter No. 12, at 11. But then, through a mystifying feat of logic, he asserts otherwise. Id. at 11-13. I fear he has attempted to project his literal sleight-of-hand skills as an amateur magician (which are considerable) into the metaphysical realm. The "trick" he uses is subtly but pervasively conflating that which he constantly tells the reader are separate and distinct inquiries: (1) statutory authority to approve a nonconsensual non-debtor "release" and, if it exists, the requisite standards for approval and (2) jurisdiction (whether subject matter or core/non-core) to approve the "release."

[35]28 U.S.C. § 1334(b). From the perspective of subject-matter jurisdiction, which is the only purpose for which the bankruptcy jurisdiction nexuses were originally enacted in 1978 (see Brubaker, 41 Wm. & Mary L. Rev. at 855-57 & nn.415, 419), such a third-party claim is *not* properly considered as "arising in" the bankruptcy case, within the meaning of the jurisdictional statute. That "arising in" provision, like its predecessors in nineteenth-century bankruptcy statutes, was enacted to bring within federal bankruptcy jurisdiction all claims by and against the bankruptcy estate. Brubaker, 41 Wm. & Mary L. Rev. at 853, 858, 868 n.454; Brubaker, 86 Am. Bankr. L.J. at 138-39.

case] properly exercised 'related to' jurisdiction over [the creditors' 'released'] claims against [the 'released'] non-debtors Basic and Lummus," reasoning as follows:

> While aspects of the § 105(a) analysis may be relevant to the "related to" jurisdiction inquiry, these inquiries are analytically distinct. Section 105(a) permits a bankruptcy court to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code. But as the statute [in § 105(c)] makes clear, § 105 does not provide an independent source of federal subject matter jurisdiction. *See also In re Johns–Manville Corp.*, 801 F.2d 60, 63 (2d Cir.1986) ("Section 105(a) does not … broaden the bankruptcy court's jurisdiction, which must be established separately[.]"). "Related to" jurisdiction must therefore exist independently of any plan provision purporting to involve or enjoin claims against non-debtors. *In re Zale Corp.*, 62 F.3d 746, 756 (5th Cir.1995). Although the Plan proponents argue that it is efficacious to use § 105(a) to extend injunctive relief in favor of non-debtors in order to create a "bigger pot" of assets for all … claimants, the exercise of bankruptcy power must be grounded in statutory bankruptcy jurisdiction.[37]

In remanding the *Millennium Lab* non-debtor "release" for reconsideration by the bankruptcy court, therefore, the district court (citing *Combustion Engineering*) was absolutely

[36]Celotex Corp. v. Edwards, 514 U.S. 300, 307-08 n.5 (1995).
[37]Combustion Eng'g, 391 F.3d at 224-25 (footnotes omitted).

correct: "The permanent release of a non-debtor, third-party's claim against another non-debtor—whether through a chapter 11 plan or otherwise—is an exercise of the Bankruptcy Court's 'related to' jurisdiction."[38] And in assessing the existence of federal subject-matter jurisdiction to "release" such non-debtor claims in *Combustion Engineering*, the Third Circuit looked to controlling precedent regarding "related to" jurisdiction to adjudicate the third-party claims sought to be "released."[39]

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[38]In re Millennium Lab Holdings II, LLC, 242 F. Supp. 3d 322, 327 (D. Del. 2017).

[39]Combustion Eng'g, 391 F.3d at 225-33. See Ralph Brubaker, Unwrapping Prepackaged Asbestos Bankruptcies (Part I): Non-Debtor "Releases" and Permanent Injunctions, 25 Bankr. L. Letter No.1, at 1, 4-6 (Jan. 2005). This aspect of the *Combustion Engineering* decision directly contradicts Logan's repeated assertions that a "bankruptcy court does *not* exercise 'related to' jurisdiction over the third-party claim when it confirms a plan with a [']release['] of that claim." Logan, 37 Bankr. L. Letter No. 12, at 15. Consequently, Logan argues that *Combustion Engineering* involved a strange and mysterious "other" kind of nonconsensual non-debtor "release" (a so-called "channeling" injunction) that we should simply ignore because such a "channeling" injunction "raises a host of issues beyond the scope of []his article." Id. at 25 n.63. Beguiling perversions of the *in rem* "channeling" rationale, to rationalize what Logan calls a "'garden variety' third-party [']release[']" of *in personam* damages liability, is one of the standard techniques for minimizing/ignoring the immense jurisdictional problems surrounding nonconsensual non-debtor "releases." See generally Brubaker, 72 Am. Bankr. L.J. at 14-22; Brubaker, 29 Bankr. L. Letter No. 8, at 1-5, 9. Thus, what is described as a so-called "channeling" injunction, in reality, is often just a "garden variety" non-debtor "release," which is:

> a mechanism that forcibly converts creditors' *in personam* claims against a nondebtor into *in rem* claims against a debtor's property. In the process, those *in personam* rights against the nondebtor are extinguished, without any assurance that the substituted *in rem* rights against the debtor's property are the equivalent of the extinguished *in personam* rights.

Brubaker, 72 Am. Bankr. L.J. at 18. Logan's description of the so-called "channeling" injunction in *Combustion Engineering* (with the forcible conversion/limitation of creditors' *in personam* damages claims coming in the form of "channeled" *in rem* claims against a "trust" set up by the confirmed plan) makes clear that he is describing precisely such a "garden variety" *in personam* nonconsensual non-debtor release. Logan's suggestion, therefore, that "a plan with [such a] [']channeling['] injunction *does* purport to decide the merits of the third-party claims" as part of approving the nonconsensual non-debtor "release" thereof, in a manner that differs from a

In *Millennium Lab*, the bankruptcy court found that it did have "related to" jurisdiction,[40] but also explicitly "question[ed] whether this 'related to' analysis is the proper analytical framework to begin with."[41] Similarly, Logan asserts that approval of a nonconsensual non-debtor "release" is an exercise of "arising under" and "arising in" jurisdiction to confirm a plan of reorganization, *not* "related to" jurisdiction over the "released" third-party non-debtor claims. That approach, though, would permit an oblique enlargement of subject matter jurisdiction, permitting a final judgment of a federal court to extinguish (by nonconsensual "release") third-party non-debtor claims that Congress has not given the federal courts any bankruptcy jurisdiction to adjudicate. As Bankruptcy Judge Rasure astutely noted, "[i]f proceedings over which the Court has no independent jurisdiction could be metamorphisized into proceedings within the Court's jurisdiction by simply including their release in the proposed plan, this court could acquire infinite jurisdiction."[42]

[T]he Court cannot permit third-party non-debtors to bootstrap their disputes into

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"garden variety" non-debtor "release," is simply untrue. Logan, 37 Bankr. L. Letter No. 12, at 15 (emphasis added). "Through the channeling sleight of hand, the court completely extinguishes the claim against the nondebtor and leaves the creditor with only its claim against the debtor's estate [or successor trust], *without even purporting to address the merits of the released nondebtor claim*." Brubaker, 72 Am. Bankr. L.J. at 19 (emphasis added). Of course, the sleight of hand here is purely by Logan; the *Combustion Engineering* court did not cabin its jurisdictional analysis with the limitations Logan seeks to attribute thereto.

[40]Although, given the bankruptcy court's conception of the relevant jurisdictional unit (as confirmation of the plan of reorganization), it is not clear that the bankruptcy court concluded that it had "related to" jurisdiction over the "released" third-party non-debtor claims, which is the "related to" analysis *Combustion Engineering* compels. See Millennium Lab, 575 B.R. at 287 n.160.

[41]Millennium Lab, 575 B.R. at 287 & n.160.

[42]In re Digital Impact, Inc., 223 B.R. 1, 11 (Bankr. N.D. Okla. 1998).

a bankruptcy case in this fashion. There must be some independent statutory basis for the Court to exercise jurisdiction over the third-parties' disputes before the Court may adjudicate them.[43]

"By using their § 105 powers to release [i.e., extinguish] nondebtor claims that they could not adjudicate directly, [federal] bankruptcy courts violate the cardinal principle that a court's 'in aid of jurisdiction' powers cannot be used to expand the court's jurisdictional reach."[44]

Such a circuitous expansion of federal courts' subject matter jurisdiction also implicates *constitutional* limitations on the scope of federal bankruptcy jurisdiction. "Released" third-party non-debtor claims are typically state-law claims for which the judicial federalism concerns surrounding subject-matter jurisdiction limitations are most acute,[45] and the "related to" grant was intended to replicate the Article III constitutional limits on the permissible reach of federal courts' bankruptcy jurisdiction.[46]

Answering the *Millennium Lab* bankruptcy court's "question," then, a "related to" jurisdictional analysis "is the proper analytical framework to begin with," as a principled limitation on the subject matter jurisdiction of the federal courts, in order to ensure that federal courts can extinguish by "release" only those third-party non-debtor claims that the Constitution

[43]In re Midway Gold US, Inc., 575 B.R. 475, 519 (Bankr. D. Colo. 2017).

[44]Brubaker, 72 Am. Bankr. L.J. at 50. See Combustion Eng'g, 391 F.3d at 224-25 n.36 ("Section 105 provides bankruptcy courts with powers of equity similar to those granted in the All Writs Act," 28 U.S.C. § 1651, which "provides that 'all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions.' ").

[45]See generally Brubaker, 41 Wm. & Mary L. Rev. at 800-13.

[46]See Brubaker, 41 Wm. & Mary L. Rev. at 796-97, 799.

and Congress have authorized federal courts to adjudicate.[47]

A Party's Constitutional Right to Final Judgment from an Article III Court

For matters within the scope of federal bankruptcy jurisdiction, absent consent of the litigants, the bankruptcy-court jurisdiction statute (Judicial Code § 157) authorizes a non-Article III bankruptcy court to enter final judgment (subject to deferential appellate review) only in "core" proceedings.[48] From its very inception, "Congress's obvious objective" with the statutory core/non-core construct was to "giv[e] bankruptcy courts as much core jurisdiction as is constitutionally permissible (but no more than is constitutionally permissible)."[49] And after the Supreme Court's decisions in *Stern* and *Arkison*, it is now clear that the determinative inquiry in deciding whether a particular proceeding is core or non-core (with only one exception) is entirely a constitutional one.[50]

Hence, a federal bankruptcy proceeding is a "core" proceeding, in which a bankruptcy judge can enter final judgment without litigant consent, if (and only if) that is *constitutionally* permissible under Article III (and even if that proceeding is *not* one that the statute itself

[47]See Brubaker, 72 Am. Bankr. L.J. at 50-54.

[48]28 U.S.C. § 157(b)(1).

[49]Brubaker, 86 Am. Bankr. L.J. at 146.

[50]See Brubaker, 33 Emory Bankr. Dev. J. at 13-14 & nn.5, 8, 40, 68-69. The only claims for which constitutional principles are not determinative are otherwise-core "personal injury tort and wrongful death claims against the estate," which the statute explicitly provides are not core proceedings. 28 U.S.C. § 157(b)(2)(B); see also id. § 157(b)(5) (mandating trial of "personal injury tort and wrongful death claims" in a federal district court); id. § 1411(a) (preserving "any right to trial by jury that an individual has under applicable nonbankruptcy law with regard to a personal injury or wrongful death tort claim").

explicitly designates as "core").[51] Conversely, if the proceeding is one in which the parties have a *constitutional* right to final judgment from an Article III judge (even if that proceeding is one that the statute itself expressly denominates as "core"), then the bankruptcy court should "simply treat the claims as non-core."[52]

It is exceedingly perplexing, therefore, why Logan devotes so much effort to arguing that, *purely as a statutory matter*, confirmation of a plan of reorganization containing nonconsensual non-debtor "releases" must be considered a proceeding "arising under" the Bankruptcy Code or "arising in" the bankruptcy case, within the meaning of the bankruptcy-court jurisdiction statute. True, the bankruptcy-court jurisdiction statute uses those two jurisdictional nexuses to define "what core proceedings are: matters arising under Title 11 or in a Title 11 case."[53] The BIG take-away from *Stern*, though, is that even an explicit statutory designation of a particular claim as "core" (such as § 157(b)(2)(C) as applied to the counterclaim at issue in *Stern*) is not entitled to even a *presumption* of constitutional validity. And as Logan acknowledges,[54] this means that the statutory designation of certain "arising under" proceedings (e.g., § 547 preference suits and § 548 fraudulent conveyance actions) as "core" may well be unconstitutional.[55] Reasoning from a statutory "core" designation to, therefore, constitutional validity (as Logan clearly does) is a

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[51]The non-exclusive nature of the list of statutorily specified "core" proceedings in § 157(b)(2), in conjunction with the so-called catch-all categories in § 157(b)(2)(A) & (O) and the extremely vague statutory specification in § 157(b)(1) of core proceedings as including all those that "arise in" a bankruptcy case, are all sufficiently capacious to give bankruptcy judges as much core jurisdiction as is constitutionally permissible. See 28 U.S.C. § 157(b)(1)-(2); id. § 157(b)(2)(A) & (O). See generally Brubaker, 86 Am. Bankr. L.J. at 136-41, 145-46.

[52]Arkison, 134 S. Ct. at 2173. See 28 U.S.C. § 157(c).

[53]Stern, 564 U.S. at 476. See Brubaker, 86 Am. Bankr. L.J. at 139-41.

[54]See Logan, 38 Bankr. L. Letter No.1, at 4-5.

[55]See Brubaker, 86 Am. Bankr. L.J. at 180-85; Brubaker, 33 Emory Bankr. Dev. J. at 50

non sequitur that completely reverses the appropriate analysis.

Specifying the Applicable Jurisdictional Unit

The constitutional analysis of both Logan and the *Millennium Lab* bankruptcy court is also stymied by their misperception of the relevant jurisdictional unit as the entire plan confirmation "proceeding." Jurisdictional analysis, however, must be applied to the "claim" at issue with a non-debtor "release." As the Third Circuit stated in prescribing "a claim by claim analysis to determine the extent of a Bankruptcy Court's [core] jurisdiction," "the claim-by-claim approach [i]s the only one consistent with the teachings of *Marathon*" and *Stern*.[56] Otherwise, a party could join a *Marathon*/*Stern*-like "claim" in an otherwise purely summary/core "proceeding" and thereby obtain final judgment on the *Marathon*/*Stern* claim from a bankruptcy judge.[57] And, of course, that is precisely the danger with nonconsensual non-debtor "releases," particularly given the nature of a plan confirmation "proceeding."

The Bankruptcy Code itself does not strictly prescribe or limit what kinds of provisions may be included in a plan of reorganization.[58] Likewise, because plan confirmation is litigated as a "contested matter," joinder rules do not prescribe or limit the kinds of jurisdictional "claims" that can be adjudicated as part of the plan confirmation "proceeding."

> Defining the scope … of a given contested matter (governed by

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n.181.

[56]Halper, 164 F.3d at 838-39.

[57]Id. at 839.

[58]See 11 U.S.C. § 1123(a)-(b).

> Bankruptcy Rule 9014) is not nearly so clean and clear [as it is for an "adversary proceeding" (largely governed by the FRCP as incorporated into the Bankruptcy Rules)]. The scope of any particular contested matter is neither prescribed nor limited by the Bankruptcy Rules; unlike adversary proceedings, those FRCP governing the joinder of claims and parties are not generally applicable to contested matters. Indeed, the only joinder FRCP that is generally applicable to [a contested matter] is the loose, permissive Rule 21:
>
>> Misjoinder of parties is not a ground for dismissing an action. On motion or on its own, the court may at any time, on just terms, add or drop a party. The court may also sever any claim against any party.
>
> There are no rigid rules or set principles, though, to determine what claims and parties should or should not be included in a particular contested matter. The bundling of claims and parties in contested matter litigation is, therefore, fluid and uncertain.[59]

Thus, if the plan confirmation "proceeding" were the relevant litigation unit for jurisdictional analysis, there is nothing intrinsic in the structure of a plan confirmation "proceeding" to prevent a non-Article III bankruptcy judge from entering final judgment on a *Marathon/Stern* "claim" that has been interjected into the plan confirmation process. Consequently, "[w]hen presented with a mixture of core and non-core claims, [a court] must

employ a claim-by-claim analysis to determine whether the bankruptcy court could enter a final order for [each] claim."[60] "[N]on-core claims do not become core simply by virtue of being pursued in the same litigation as core claims."[61]

The appropriate constitutional analysis, therefore, must seek to determine whether it is constitutional for a non-Article III bankruptcy judge to enter final judgment on the jurisdictional "claim" at issue in approving a nonconsensual non-debtor "release." For analytical clarity, then, we can return to our illustrative jurisdictional "claim": the request that a non-Article III bankruptcy court extinguish (by "release") C's common-law fraud claim against ND.

Specifying the Constitutional Nature of the Jurisdictional Claim at Issue

The Supreme Court has repeatedly quoted[62] (as did the Court in *Stern*[63]) the venerable *Murray's Lessee* decision as the definitive statement of the kinds of claims on which a party is entitled to final judgment from an Article III court: Congress cannot "withdraw from judicial cognizance any matter which, *from its nature*, is the subject of a suit at the common law, or in equity, or admiralty,"[64] or what Justice Rehnquist described in his *Marathon* concurrence as "the stuff of the traditional actions at common law tried by the courts at Westminster in 1789."[65] Likewise, in federal bankruptcy proceedings, the Court focused on the *nature* of the claim being

[59]Brubaker, 35 Bankr. L. Letter No. 6, at 8.
[60]Dunmore, 358 F.3d at 1114.
[61]Exide, 544 F.3d at 220.
[62]See Brubaker, 33 Emory Bankr. Dev. J. at 38 & n.122.
[63]See Stern, 564 U.S. at 484.
[64]Murray's Lessee v. Hoboken Land & Improvement Co., 59 U.S. (18 How.) 272, 284 (1856) (emphasis added).
[65]N. Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 90 (1982) (Rehnquist,

asserted in determining whether "the matter at issue, *from its nature*, was the subject of a plenary suit" that could not be heard by a non-Article III bankruptcy tribunal[66] and, thus, "could only be enforced by a plenary suit, at law or in equity," in an Article III court.[67]

Returning to the jurisdictional claim between C and ND, a nonconsensual non-debtor "release" seeks to extinguish C's common-law fraud claim against ND. While a creditor's fraud claim against a debtor's bankruptcy estate is a quintessential traditional "summary" matter, appropriately adjudicated by a non-Article III bankruptcy tribunal, a creditor's fraud claim against a non-debtor indisputably is not. Indeed, until the Bankruptcy Reform Act of 1978, there was generally no "bankruptcy" jurisdiction whatsoever over such a third-party non-debtor claim, and the Founding generation certainly would not have considered such a claim to have been any part of the "bankruptcy" proceedings at all, much less an appropriate matter for adjudication by bankruptcy commissioners. C's fraud claim against ND, therefore, is "the stuff of the traditional actions at common law tried by the courts at Westminster in 1789."[68]

A Non-Debtor "Release" Is a Final Judgment on the "Released" Claim

Logan and the *Millennium Lab* bankruptcy court, however, object to this framing of the nature of the jurisdictional "claim" at issue in approving a nonconsensual non-debtor "release" of C's fraud claim against ND. Their principal objection is that in approving a nonconsensual non-

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J., concurring).

[66]Brubaker, 33 Emory Bankr. Dev. J. at 54 (emphasis added) (discussing *Weidhorn v. Levy*, 253 U.S. 268, 272 (1920) ("In order to set aside these [allegedly fraudulent] conveyances [made by the bankrupt] and subject the property to the administration of the court of bankruptcy a plenary suit was necessary.")).

[67]Bardes v. Hawarden Bank, 178 U.S. 524, 532 (1900).

debtor "release" of C's fraud claim against ND, the court does not actually address and adjudicate "the merits" of C's claim against ND under the applicable state common law of fraud; rather, the court applies a federal bankruptcy law standard to determine whether that third-party non-debtor fraud claim should be extinguished by nonconsensual "release" thereof. All of that is true, but why that would be at all relevant is a mystery. The contention that those differences justify allowing a non-Article III bankruptcy judge to extinguish C's fraud claim against ND by "release" loses sight of the nature of the constitutional right at issue and that which it protects.

Because C's common-law fraud claim against ND is "the stuff of the traditional actions at common law,"[69] that claim is protected by the Article III guarantee that it cannot be "withdraw[n] from judicial cognizance."[70] In other words, if that claim is to be subjected to federal "judicial Power" within the meaning of Article III, § 1, then that judicial power must be exercised by a judge enjoying the Article III, § 1 protections of lifetime tenure and irreducible compensation.[71] Most importantly, "*Stern v. Marshall* indicates that the determinative aspect of the Article III 'judicial Power' that must remain in the Article III district courts" with respect to such a traditional private-rights claim "is the power to enter final judgment" on that claim.[72] Indeed, the *Stern* Court stated its holding, as follows: "The Bankruptcy Court in this case exercised the judicial power of the United States by entering final judgment on a common law tort claim, even though the judges of such courts enjoy neither tenure during good behavior nor

[68]Marathon, 458 U.S. at 90 (Rehnquist, J., concurring).
[69]Marathon, 458 U.S. at 90 (Rehnquist, J., concurring).
[70]Murray's Lessee, 59 U.S. (18 How.) at 284.
[71]Stern, 564 U.S. at 484.
[72]Brubaker, 86 Am. Bankr. L.J. at 159.

salary protection."[73] The Court's consistent, repeated formulation, throughout its opinion, of that which was unconstitutional in *Stern* was "the Bankruptcy Court's entry of final judgment on" that claim.[74]

Likewise, then, the determinative feature indicating that a non-Article III bankruptcy court's final judgment approving a nonconsensual non-debtor "release" of C's common-law fraud claim against ND is an unconstitutional exercise of federal "judicial Power" over that claim, is that extinguishment of the claim by nonconsensual "release" thereof *is* a final judgment on C's fraud claim against ND. That is made clear by the Supreme Court's *Stoll v. Gottlieb*[75] and *Travelers Indemnity Co. v. Bailey*[76] decisions.

Stoll v. Gottlieb, decided in 1938 under the Bankruptcy Act of 1898, involved the preclusive effect of a nonconsensual non-debtor "release" provision in a confirmed plan of reorganization (before such provisions acquired a veneer of legitimacy and the euphemistic "release" moniker). Third-party non-debtors had guaranteed the corporate debtor's bond debt, and a "proposed plan of reorganization with [a] provision for the extinction of the guaranty" was confirmed by final judgment of a district court sitting in bankruptcy.[77] Subsequently, one of the bondholders, who had been properly notified of the plan confirmation proceedings and, thus, made a party thereto, filed suit in an Illinois state court against the guarantors seeking to enforce the guaranty obligation. The principal question in that state-court litigation was the claim preclusive *res judicata* effect of the order confirming the debtor's plan of reorganization, with

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[73]Stern, 564 U.S. at 469
[74]Stern, 564 U.S. at 487.
[75]Stoll v. Gottlieb, 305 U.S. 165 (1938).
[76]Travelers Indemn. Co. v. Bailey, 557 U.S. 137 (2009).

the state appellate courts (including the justices of the Illinois Supreme Court) sharply differing on that question.[78] The U.S. Supreme Court granted certiorari "to determine the effect to be given decrees of a court of the United States,"[79] and held that the bondholder's guaranty claim was extinguished by the confirmation order. And the Supreme Court more recently reaffirmed the holding of *Stoll v. Gottlieb*, as applied to a nonconsensual non-debtor "release" provision in a plan of reorganization confirmed by final order of a non-Article III bankruptcy court, in the 2009 *Travelers Indemnity Co. v. Bailey* decision.[80]

For our present purposes, the technical issue of *res judicata* law decided in *Stoll v. Gottlieb* and *Bailey*—precluding any collateral attack on the subject matter jurisdiction of either a district court or a bankruptcy court that approved a non-debtor "release," which jurisdiction the Court assumed, without deciding, was *nonexistent* in each case—is less important than the bottom-line holding that a nonconsensual non-debtor "release" provision in a confirmed plan of reorganization extinguishes a "released" non-debtor claim, e.g., C's state-law fraud claim against ND. The most elemental aspect of *res judicata* law resides in the fact that that which gives rise to the claim preclusive bar of *res judicata* is a *final judgment* on the claim at issue.[81] The ultimate holding of both *Stoll v. Gottlieb* and *Bailey*, therefore, is that an order confirming a plan containing a nonconsensual non-debtor "release" of C's state-law fraud claim against ND *is a final judgment on that claim*. In the words of the Restatement (Second) of Judgments, by virtue

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[77]Stoll v. Gottlieb, 305 U.S. at 168-69.

[78]See Gottlieb v. Crowe, 289 Ill. App. 595, 7 N.E.2d 469 (1937), rev'd, 368 Ill. 88, 12 N.E.2d 881 (1938), rev'd 305 U.S. 165 (1938).

[79]Stoll v. Gottlieb, 305 U.S. at 167.

[80]Bailey, 557 U.S. at 151-54. See Brubaker, 29 Bankr. L. Letter No. 8, at 5.

[81]See Restatement (Second) of Judgments § 17 (1982).

of the nonconsensual non-debtor "release" provision in the plan of reorganization, confirmed by final judgment of a federal court, C's state-law fraud claim against ND "is extinguished and the [confirmation] judgment bars a subsequent action on that claim."[82]

In confirming a plan containing a nonconsensual non-debtor "release" of C's state-law fraud claim against ND, therefore, it is "clear that the bankruptcy court entered a judgment which, in releasing [ND] from any liability to [C] on the [state-law fraud claim], extinguished [that] claim."[83] Indeed, that is the entire purpose and function of a nonconsensual non-debtor "release"—to forever and definitively extinguish and bar, by final judgment of a federal court, any collateral suit on the third-party non-debtor claims "released" thereby. The confirmation order, then, is a final judgment on each and every third-party non-debtor claim coming within the terms of the "release" provision.[84]

Entry of a final judgment to which the claim preclusive bar of *res judicata* attaches <u>is</u> the exercise of Article III "judicial Power" that must remain in an Article III district court with respect to a traditional private-rights claim such as C's state-law fraud claim against ND.

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[82]Restatement (Second) of Judgments § 17(2).

[83]Republic Supply Co. v. Shoaf, 815 F.2d 1046, 1054 (5th Cir. 1987).

[84]The context in which claim preclusion is often addressed is determining whether a particular claim that was *not* explicitly disposed of by a judgment is nonetheless barred. See Clyde Spillenger, Principles of Conflict of Laws 199 (2d ed. 2015). That sometimes-difficult aspect of claim preclusion law is, however, not implicated by non-debtor "releases," since the terms of the "release" itself define which third-party non-debtor claims are being extinguished by the "release." The confirmation order, therefore, is a final judgment extinguishing those (and only those) non-debtor third-party claims expressly identified by the terms of the "release" itself. See Bailey, 557 U.S. at 147-51, 155; Brubaker, 29 Bankr. L. Letter No. 8, at 5-9. Cf. Spillenger, Conflict of Laws, at 199 (describing such a scenario as the "easy case" in claim preclusion law). In other words, unlike most judgments, a non-debtor "release" explicitly addresses its claim preclusive *res judicata* scope and effect, because invoking the claim preclusive *res judicata* bar of a final judgment is the entire purpose and function of the "release" judgment.

Indeed, the context in which the Supreme Court in *Stern v. Marshall* was determining which court (the bankruptcy court or the district court) could, consistent with Article III, enter final judgment on the claim at issue, was for purposes of determining the claim preclusive *res judicata* effect to be afforded the final judgment of a federal court (either the bankruptcy court or the district court) versus the conflicting final judgment of a Texas state court.[85]

A "bankruptcy court's confirmation order … is a final judgment," and the plan's non-debtor "release provisions and the bankruptcy court [confirmation] order expressly apply to the same parties and claims as [those of any] suit" on the released non-debtor claims.[86] Because such third-party non-debtor claims are "the stuff of the traditional actions at common law"[87] that cannot be "withdraw[n] from judicial cognizance,"[88] it is unconstitutional for a non-Article III bankruptcy court to enter such a final judgment "releasing" (i.e., extinguishing) those claims.

The Celotex Corp. v. Edwards *Case*

The Supreme Court addressed the constitutional prohibition against a non-Article III bankruptcy court entering final judgment on such a non-debtor third-party claim in *Celotex Corp. v. Edwards*.[89] In contrast to a nonconsensual non-debtor "release," and as the Court emphasized, the particular relief granted by the non-Article III bankruptcy court in *Celotex* was *not* a final judgment on the third-party non-debtor claims at issue. Consequently, the bankruptcy judge's

[85]See Stern, 564 U.S. at 467-73; Brubaker, 86 Am. Bankr. L.J. at 133-35.
[86]Trulis v. Barton, 107 F.3d 685, 691 (9th Cir. 1997).
[87]Marathon, 458 U.S. at 90 (Rehnquist, J., concurring).
[88]Murray's Lessee, 59 U.S. (18 How.) at 284.
[89]Celotex Corp v. Edwards, 514 U.S. 300 (1995). See generally Brubaker, 72 Am. Bankr. L.J. at 36-39, 44-47, 50 & n.208.

order was *not* unconstitutional.

The particular non-debtor third-party claims at issue in *Celotex* were claims of the debtor's prebankruptcy judgment creditors against sureties who had, before the debtor filed Chapter 11, posted supersedeas bonds securing the debtor's obligation to pay those judgments if they were affirmed on appeal. After the debtor filed Chapter 11, the bankruptcy court issued a temporary § 105 status-quo injunction, as a supplement to the automatic stay of § 362, staying the judgment creditors from taking any action to enforce a supersedeas bond against the surety thereon. The Supreme Court ultimately affirmed the jurisdiction of the bankruptcy court to temporarily enjoin prosecution of the third-party non-debtor claims at issue because those claims were within the subject-matter grant of federal bankruptcy jurisdiction over claims "related to" the debtor's bankruptcy case.

Most significantly, for our present purposes, Justice Stevens penned a lengthy and impassioned dissent (joined by Justice Ginsburg), arguing that "the majority attaches insufficient weight to the fact that the challenged injunction was issued by a non-Article III judge."[90] The majority's response to that argument highlights the critical importance of a *final judgment* on a non-debtor third-party claim in demarcating the boundary between (i) the permissible powers of a non-Article III bankruptcy judge and (ii) the Article III "judicial Power" that must and can only be exercised by an Article III district judge.

The *Celotex* majority did not disagree with Justice Stevens's contention that the third-party non-debtor claims at issue were, like the claim at issue in *Marathon*, "the stuff of the

[90]Celotex, 514 U.S. at 313-14.

traditional actions at common law"[91] that cannot be "withdraw[n] from judicial cognizance"[92]—what the current jurisdictional statute categorizes as a non-core "related to" claim. Moreover, both majority and dissent agreed that the jurisdictional statute provides (as mandated by the constitutional holding of *Marathon*) that "only the district court has the power to enter 'any final order or judgment' " on such a non-debtor third-party claim.[93] The *Celotex* majority, though, was untroubled by the bankruptcy court's temporary stay of the non-debtor third-party claims because that "Section 105 injunction [wa]s only an *interlocutory stay*" of the third-party non-debtor claims.[94] "Thus, the [non-Article III] Bankruptcy Court did not lack jurisdiction … to issue the Section 105 injunction because that injunction was *not* a 'final order or judgment' " on those third-party non-debtor claims.[95]

Logan (and *Millennium Lab* bankruptcy court), therefore, are undoubtedly correct that *Marathon* and *Stern* cannot be read so broadly as to prohibit a non-Article III bankruptcy court from entering any order that "affects" or "impacts" a third-party non-debtor claim. *Marathon*

[91]Marathon, 458 U.S. at 90 (Rehnquist, J., concurring).

[92]Murray's Lessee, 59 U.S. (18 How.) at 284.

[93]Celotex, 514 U.S. at 321-22 (Stevens, J., dissenting) (quoting 28 U.S.C. § 157(c)(1)).

[94]Celotex, 514 U.S. at 309 n.7 (emphasis in original).

[95]Celotex, 514 U.S. at 309 n.7 (emphasis added). Indeed, Justice Stevens "agree[d] with the majority that the Bankruptcy Judge's order [wa]s a temporary injunction, and thus it [wa]s not a 'final order or judgment' " on the third-party non-debtor claims at issue. Celotex, 514 U.S. at 324 n.11 (Stevens, J, dissenting). He would, however, have interpreted the core jurisdiction statute more narrowly: "I believe that a statutory scheme that deprives a bankruptcy judge of jurisdiction to 'determine' a case also deprives that judge of jurisdiction to issue binding injunctions—even temporary ones—that would prevent an Article III court with jurisdiction over the case from determining it." Id. The view of the *Celotex* majority, though, is consistent with a long line of Supreme Court decisions, decided within the framework of the Supreme Court's summary-plenary jurisprudence, that distinguished between (i) the summary jurisdiction of a non-Article III referee to temporarily enjoin even a plenary suit from going forward and (ii) the plenary jurisdiction of only an Article III district court to finally adjudicate a plenary matter. See

and *Stern*, however, *do* prohibit a non-Article III bankruptcy judge from entering a *final judgment* on such a third-party non-debtor claim, and a plan confirmation order approving a nonconsensual non-debtor "release" provision, and *permanently* enjoining the "released" (i.e., extinguished) third-party non-debtor claims, *is a final judgment* on those claims.[96]

The Constitutionality of a Non-Article III Bankruptcy Judge's Final Judgment Is Not Determined by the Grounds for the Judgment

Logan seeks to obscure the inescapable conclusion that a nonconsensual non-debtor "release" *is* a final judgment on the "released" non-debtor claims, with multiple immaterial observations. Again, the principal refrain of Logan (and the *Millennium Lab* bankruptcy court) is that in approving a nonconsensual non-debtor "release" of, e.g., C's fraud claim against ND, the court does not actually address and adjudicate "the merits" of C's claim against ND under the applicable state common law of fraud; rather, the court applies a *federal* bankruptcy law standard to determine whether that third-party non-debtor fraud claim should be extinguished by nonconsensual "release" thereof. There are two distinct assertions embedded in that observation; neither, however, permits a non-Article III bankruptcy judge to issue a final judgment confirming a plan containing nonconsensual non-debtor "release" provisions.

First, that a court does not address and adjudicate "the merits" of a claim does not deprive an order extinguishing that claim from the force and effect of a final judgment on that claim. For

Brubaker, 72 Am. Bankr. L.J. at 22-28, 44-47.

[96]The *Millennium Lab* bankruptcy court stated that "examin[ing] the legal consequences of the confirmation order to find fault with the entry of the order" is "backwards reasoning." 575 B.R. at 283. That, however, is precisely the analytical method that the Court employed in *Stern*.

example, assume that C's state-law fraud claim against ND is "related to" D's bankruptcy case, and ND brings a declaratory judgment action in the bankruptcy court claiming that C's state-law fraud claim is barred by an applicable statute of repose. Can the non-Article III bankruptcy judge issue a declaratory judgment that C's state-law fraud claim is extinguished and forever barred by the statute of repose simply because that would not require the court to address and adjudicate "the merits" of C's claim against ND under the applicable state common law of fraud? Obviously not; that declaratory judgment would be a final judgment on C's state-law fraud claim against ND that could only be entered by an Article III district court.[97]

The further assertion of Logan and the *Millennium Lab* bankruptcy court, though, is that, in the case of a nonconsensual non-debtor "release," the declaratory judgment from the bankruptcy court that C's state-law fraud claim against ND is extinguished and forever barred is entered on the basis of *federal bankruptcy law* that extinguishes that claim. The proposition that a non-Article III bankruptcy judge can finally adjudicate any and all matters of federal bankruptcy law is, however, highly dubious, and in the case of nonconsensual non-debtor

[97]See Restatement (Second) of Judgments § 33 (effect of declaratory judgments); Perez v. PBI Bank, Inc., 69 F.3d 906, 910 (N.D. Ind. 2014) ("when a party seeks a dismissal of a lawsuit based on a statute of repose, it is seeking a judgment on the merits which necessarily involves the power of the court to decide the matter in the first instance"). The traditional terminology of preclusion law captures the notion that the judgment is, indeed, a final judgment extinguishing and barring further suit on the claim by characterizing it as a judgment "on the merits." See David L. Shapiro, Civil Procedure: Preclusion in Civil Actions 39-40 (2001). And ironically (given the argument of Logan and the *Millennium Lab* bankruptcy court), the courts have uniformly concluded that a confirmation order approving a nonconsensual non-debtor "release" provision *is* a final judgment "on the merits" of the "released" third-party non-debtor claims. See, e.g., Republic Supply Co. v. Shoaf, 815 F.2d at 1053 (holding that "the bankruptcy court, applying bankruptcy law, confirmed the Plan and disposed of [non-debtor's] liability on" the third-party non-debtor claim at issue and "[i]t was therefore a final judgment on the merits" of the "released" claim).

"releases," is simply untrue.

By defining "core" matters to include all proceedings "arising under" the Bankruptcy Code,[98] it was certainly Congress's intent that bankruptcy courts should finally adjudicate any and all matters of federal bankruptcy law. As we saw with federal subject matter jurisdiction, though, that is true only with respect to claims that are *not* premised upon Code § 105. Logan acknowledges that a bankruptcy court is necessarily relying upon the authority of Code § 105(a) in fashioning the federal bankruptcy law standards for approving a nonconsensual non-debtor "release," and § 105(c) makes clear that "Section 105(a) does not … broaden the bankruptcy court's jurisdiction, which must be established separately."[99] As Justice Stevens stated in his *Celotex* dissent, the mere request for § 105 relief "cannot be a jurisdictional bootstrap enabling a bankruptcy court to exercise jurisdiction that would not otherwise exist."[100] As is also true with federal subject matter jurisdiction, then (discussed above), there must be an independent basis (apart from the reliance upon § 105(a)) for a bankruptcy court to enter final judgment on "released" third-party non-debtor claims.

Moreover, even if it were clear that Congress did intend for approval of a nonconsensual non-debtor "release" to be a core matter "arising under" the Bankruptcy Code, the Supreme Court's decisions in *Katchen v. Landy*,[101] *Granfinanciera*,[102] *Langenkamp v. Culp*,[103] and

[98]28 U.S.C. § 157(b)(1).
[99]In re Johns-Manville Corp., 801 F.2d 60, 63 (2d Cir. 1986).
[100]Celotex, 514 U.S. at 327 (Stevens, J., dissenting).
[101]Katchen v. Landy, 382 U.S. 323 (1966).
[102]Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989).
[103]Langenkamp v. Culp, 498 U.S. 42 (1990).

Stern[104] "call[] into doubt the constitutionality of the entire category of 'arising under' core proceedings as an independent basis for final judgment by a non-Article III bankruptcy judge."[105] Indeed, Logan acknowledges that this is the case and that the constitutionality of a non-Article III bankruptcy judge entering final judgment cannot turn on whether state law or federal law provides the grounds for decision.[106]

The constitutionality of a non-Article III bankruptcy judge entering final judgment turns on the nature of the claim adjudicated thereby—whether it is "the stuff of the traditional actions at common law"[107] that cannot be "withdraw[n] from judicial cognizance."[108] A claimant has a constitutional right to final judgment from an Article III judge on any such traditional private-rights claim involving "the liability of one individual to another under the law as defined."[109] A confirmation order approving a nonconsensual non-debtor "release" provision *is* a final judgment on such traditional private-rights claims and, therefore, can only be entered by an Article III district court judge. Indeed, that constitutional issue is undoubtedly why Code § 524(g) requires that a confirmation order approving non-debtor "releases" of certain third-party non-debtor asbestos claims (expressly authorized thereby) must be "issued or affirmed by the district court."[110]

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[104]See generally Brubaker, 86 Am. Bankr. L.J. at 180-85.
[105]Brubaker, 86 Am. Bankr. L.J. at 183.
[106]Logan, 38 Bankr. L. Letter No. 1, at 4-5.
[107]Marathon, 458 U.S. at 90 (Rehnquist, J., concurring).
[108]Murray's Lessee, 59 U.S. (18 How.) at 284.
[109]Stern, 564 U.S. at 489 (quoting Crowell v. Benson, 285 U.S. 22, 51 (1932)).

The Constitutionality of a Non-Article III Bankruptcy Judge's Final Judgment Is Not Determined by the Kind of "Proceeding" in Which It Is Entered

Logan makes one other argument that warrants a brief comment, because it is the kind of argument that often seems attractive but that is ultimately unsound.[111] Proceeding (no pun intended) from the erroneous assumption that the plan confirmation "proceeding" is the relevant unit of jurisdictional analysis, Logan argues that the right to final judgment from an Article III court only attaches to "proceedings" that resemble traditional "suits" at law or in equity:

> It is no accident that the [*Murray's Lessee* and] *Granfinanciera* Court[s] used the word "suit" to describe the sort of matter reserved for Article III adjudication. … [T]he sort of matter that requires Article III adjudication generally involves a plaintiff and a defendant, proceeds before a court pursuant to the full rules of civil procedure and ultimately results in a disposition on the merits of the claim.[112]

Initially, Logan's conception of the kind of "suit" to which constitutional rights attach is unduly narrow. For example, when Mr. Chief Justice Marshall famously posed that question, "What is a suit?,"[113] his response was not at all restrictive. Rather, he described the concept in the broadest possible terms as "the prosecution, or pursuit, of some claim, demand, or request …

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[110] 11 U.S.C. § 524(g)(3)(A).

[111] For example, a similar (and similarly misguided) argument was accepted by many courts in the context of determining the extent of states' constitutional sovereign immunity in federal bankruptcy proceedings. See generally Brubaker, 76 Am. Bankr. L.J. at 534-56.

[112] Logan, 38 Bankr. L. Letter No. 1, at 5.

[113] Cohens v. Virginia, 19 U.S. (6 Wheat.) 264, 407 (1821).

in a Court of justice," encompassing "every species of remedy" by which a party "claims to obtain something to which he has a right."[114] Chief Justice Marshall, therefore, perceived a "suit" in "law language" as consisting of "a diversity of suits and actions" for "the lawful demand of one's right."[115] This broad framing of a "suit," in which parties thereto may have a right to final judgment from an Article III court, would certainly encompass a plan confirmation proceeding approving nonconsensual non-debtor "release" provisions.

More fundamentally, though, Logan misperceives that to which the Article III constitutional right attaches. Logan is probably correct, that in describing those private-rights matters in which the litigants have a constitutional right to final judgment from an Article III court, the *Murray's Lessee* Court was referring to the kinds of formal suits conducted in the English superior courts of law, equity, and admiralty at the time of the Founding. But the point of that Court's famous description was not that the Article III right attaches because there is such a formal "suit"; the point was that certain matters, because of their nature, *had to be adjudicated* through a formal suit in a superior court: "We do not consider congress can … withdraw from judicial cognizance any *matter*, which *from its nature*, is the *subject* of a suit at the common law, or in equity, or admiralty."[116] Likewise, in its summary-plenary jurisprudence in the context of bankruptcy adjudications, the Court focused upon the *nature* of the claim being asserted in order to determine whether that claim "could only be enforced by a plenary suit, at law or in equity" in an Article III court.[117] The constitutional right to final judgment from an Article III court,

[114]Cohens v. Virginia, 19 U.S. (6 Wheat.) at 407-08.
[115]Cohens v. Virginia, 19 U.S. (6 Wheat.) at 407-08.
[116]Murray's Lessee, 59 U.S. (18 How.) at 284 (emphasis added).
[117]Bardes v. Hawarden Bank, 178 U.S. at 532. See also Weidhorn v. Levy, 253 U.S. at

therefore, attaches to certain claims, which by their nature, are the same kinds of claims that were (required to be) adjudicated by formal suit in an English superior court in 1789.

Were the constitutional right as ephemeral as Logan asserts, then Congress could indeed "withdraw from judicial cognizance"[118] the final adjudication of a private-rights matter, involving "the liability of one individual to another under the law as defined,"[119] via the simple expedient of enacting a procedural rule requiring that those private-rights claims be adjudicated as contested matters rather than adversary proceedings, and for good measure, that the contested matter adjudicating those private rights can be joined and determined in conjunction with a plan confirmation proceeding.

To say that a non-Article III bankruptcy judge can enter a final judgment extinguishing and forever barring any suit on the private-rights claim of one non-debtor against another non-debtor, e.g., C's state-law fraud claim against ND, simply because the bankruptcy judge enters that final judgment in a plan confirmation proceeding that does not resemble a traditional "suit" at law or in equity in the superior courts of eighteenth-century England, and because there is some federal bankruptcy law that authorizes extinguishing that private-rights claim, is to say that final adjudication of that private-rights claim can be "withdraw[n] from judicial cognizance."[120] Article III categorically forbids that.

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272 ("In order to set aside these [allegedly fraudulent] conveyances [made by the bankrupt] and subject the property to the administration of the court of bankruptcy a plenary suit was necessary.").

[118]Murray's Lessee, 59 U.S. (18 How.) at 284.

[119]Stern, 564 U.S. at 489 (quoting Crowell v. Benson, 285 U.S. at 51).

[120]Murray's Lessee, 59 U.S. (18 How.) at 284.

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The *Sunnyslope* Cram-Down Collateral Valuation

Hon. Cynthia A. Norton
United States Bankruptcy Judge
Western District of Missouri

Bankruptcy Law Letter

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Secured Creditor Cram-Down Valuations and Chapter 11's Raison d'Etre

By Ralph Brubaker

An en banc panel of the Ninth Circuit recently issued a cram-down valuation decision in the *Sunnyslope Housing* case, which presents, as the majority described it, "the atypical case" in which "foreclosure value" of an undersecured creditor's collateral "*exceeds* replacement value, which is tied to the debtor's 'actual use' of the property in the proposed reorganization."[1] By an 8-3 vote, the en banc court held that the collateral should be valued at its *lower* replacement value, reversing the earlier 2-1 decision of a 3-judge panel.[2]

The *Sunnyslope* case presents a fascinating study in the meaning and implications of the Supreme Court's cram-down valuation decision in *Associates Commercial Corp. v. Rash*[3] and ultimately exposes a familiar philosophical divide in attitudes about the proper purpose and function of Chapter 11. The reversal of the conventional relationship between foreclosure and replacement values in *Sunnyslope* was produced by collateral comprised of an affordable housing project encumbered by low-income-rent restrictive covenants.

The Sunnyslope Affordable Housing Project

From 2005-2007, Sunnyslope Housing Limited Parnership developed an apartment complex that it intended to operate as an affordable housing community. Sunnyslope obtained financing for this development from three secured loans.

1. Capstone Advisors, LLC provided the bulk of the debt financing, with an $8.5 million loan insured by the U.S. Department of Housing and Urban Development (HUD) and that was funded by the sale of municipal bonds issued by the Phoenix Industrial Development Authority (Phoenix IDA). The Capstone loan was secured by a first-priority deed of trust on the Sunnyslope property.

2. The City of Phoenix Housing Department (Phoenix Housing) lent Sunnyslope an additional $3 million, secured by a second-priority deed of trust on the Sunnyslope property.

3. Sunnyslope also obtained $500,000 of additional public loan

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financing from the State of Arizona Department of Housing (Arizona Housing), secured by a third-priority deed of trust on the Sunnyslope property.

As part of its development of the apartment complex as an affordable housing project, and in conjunction with the loans it obtained to finance the development, Sunnyslope entered into a number of agreements that required the apartment complex to be operated as affordable housing, each of which was also recorded as restrictive covenants "running with the land" that would encumber the permissible uses of the property in the hands of any successor owner of the property.

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1. Sunnyslope entered into a Regulatory Agreement with HUD, insurer of the Capstone Loan, that required the apartment complex be used for affordable housing and that limited the rents that tenants could be charged to amounts established by HUD. The requirements of the HUD Regulatory Agreement were also expressly incorporated into and made a part of the first-priority Capstone deed of trust.

2. Sunnyslope entered into a Regulatory Agreement and Declaration of Restrictive Covenants with the Phoenix IDA, the funder of the Capstone loan, that required operation of the apartment complex in accordance with the affordable housing requirements of the Internal Revenue Code necessary to preserve the tax-exempt status of interest payments on the Phoenix IDA bonds. The Phoenix IDA restrictive covenants, though, were "subordinated" to those of HUD, as follows: "The provisions of this Agreement are subject and subordinate to the National Housing Act, all applicable HUD insurance . . . regulations and related administrative requirements, [and] the [Capstone] Mortgage Loan Documents."[4] The Phoenix IDA restrictive covenants also contained a foreclosure-termination provision: "This Agreement and each and all of the terms hereof, shall terminate and be of no further force or effect in the event of a foreclosure of the [Capstone] lien of Mortgage or delivery of a deed in lieu of foreclosure."[5]

3. In conjunction with its $3 million loan from Phoenix Housing, Sunnyslope executed a Declaration of Affirmative Land Use Restrictive Covenants agreement, pursuant to which Sunnyslope agreed that 23 units of the apartment complex would be set aside for low-income housing subject to rent caps established by Phoenix Housing. The Phoenix Housing restrictive covenants also contained a subordination provision[6] and a foreclosure-termination provision,[7] each substantially identical to the corresponding provision in the Phoenix IDA restrictive covenants.

4. Arizona Housing, in conjunction with its

$500,000 loan, required Sunnyslope to execute a Declaration of Covenants, Conditions, and Restrictions agreement, requiring five units of the apartment complex to be set aside as "State-assisted units" for low-income housing subject to rent caps established by Arizona Housing. The Arizona Housing restrictive covenants also included a subordination provision[8] and a foreclosure-termination provision[9] nearly identical to those in the Phoenix IDA and Phoenix Housing covenants.

5. In order to qualify for low-income housing tax credits available under the Internal Revenue Code, Sunnyslope executed an additional restrictive-covenant agreement with Arizona Housing, as the designated Arizona agency for allocation of the federal tax credits, entitled a Declaration of Affirmative Land Use and Restrictive Covenants Agreement (the Tax Credit restrictive covenants). This agreement required Sunnyslope to maintain all 150 units of the apartment complex as "low income units" within the meaning of the Internal Revenue Code, and like all the other non-HUD restrictive covenants, the Tax Credit restrictive covenants contained both a subordination provision[10] and a foreclosure-termination provision.[11]

The apartment complex was completed and placed into service in 2008, but by the summer of 2009, Sunnyslope defaulted on the Capstone loan, triggering payment of the HUD insurance and a corresponding subrogation and assignment of the Capstone loan to HUD. In September 2010, HUD sold the Capstone loan, as part of a pool of delinquent loans, to First Southern National Bank for approximately $5 million. In conjunction with that sale, HUD released Sunnyslope from all of the restrictive covenants contained in the recorded HUD Regulatory Agreement, but the loan sale agreement explicitly advised First Southern that the apartment complex securing the Capstone loan remained subject to all other "covenants, conditions and restrictions . . . of record."[12]

Of course, a foreclosure of the Capstone loan would terminate all of the remaining restrictive covenants, pursuant to the express terms thereof. And in October 2010, First Southern commenced state-court foreclosure proceedings in which a receiver was appointed. Sale of the property was noticed, and the receiver agreed to a sale of the property for $7.65 million. That sale (and, thus, foreclosure of the Capstone deed of trust) never took place, however, because Sunnyslope's Chapter 11 proceedings were commenced in January of 2011.

The Sunnyslope Reorganization Plan and the Collateral Valuation Dispute

First Southern filed a proof of claim stating that the petition-date balance owing on the Capstone loan was nearly $9 million. The central issue in Sunnyslope's Chapter 11 proceedings was determining what portion of First Southern's $9 million claim was secured, which of course turned on the value of the apartment complex that served as collateral for that claim.

Sunnyslope filed a plan of reorganization proposing to continue to operate the apartment complex as low-income housing, in accordance with the remaining restrictive covenants encumbering the property. The Sunnyslope plan proposed to pay First Southern's "allowed secured claim" (under Code § 506(a)) in full, with interest, over a 40-year term. First Southern filed a § 506(a) motion to determine the amount of its "allowed secured claim," which motion was tried in advance of and to facilitate the bankruptcy court considering confirmation of Sunnyslope's plan.

Both Sunnyslope and First Southern presented expert testimony regarding the value of the apartment complex. Debtor's expert valued the property at (i) $7 million if it were *not* encumbered by the affordable housing restrictive covenants, and (ii) $2.6 million if it remained encumbered by those restrictive covenants. The comparable valuations by First Southern's expert were (i) $7.74 million *without* the restrictive covenants, and (ii) $4.885 million *with* the restrictive covenants. In conjunction with the latter valuation, the First Southern expert also valued the low-income federal tax credits associated with ownership of the covenant-restricted property (which Sunnyslope's expert did not value) at an additional $2.91 million, for a total value of $7.795 million if the property remained encumbered by the restrictive covenants.

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The bankruptcy court held that "value would have to be based upon the value of the property as it is owned by the Debtor, which means as low-income property, and that you would not ascribe any value to the tax credits unless First Southern can show that it has a lien on the tax credits, and I don't think it has."[13] And the bankruptcy court then accepted the valuation evidence of Sunnyslope's expert and, thus, set the § 506(a) amount of First Southern's "allowed secured claim" at $2.6 million.

After the bankruptcy court issued that valuation order, First Southern elected to have its entire $9 million claim treated as secured under Code § 1111(b)(2). With respect to Sunnyslope's $9 million secured claim, the Sunnyslope plan proposed (1) that First Southern would retain its lien on the apartment complex to secure payment in full of that $9 million secured claim, in accordance with Code § 1129(b)(2)(A)(i)(I), and (2) Sunnyslope would pay First Southern (a) $2.6 million, with interest, over a 40-year period, and (b) a balloon payment of the $6.4 million balance owing at the end of that 40-year term (at which time, all of the low-income-rent restrictive covenants would have expired by their terms), in accordance with Code § 1129(b)(2)(A)(i)(II).

The bankruptcy court confirmed Sunnyslope's plan over the objection of First Southern, finding that the plan's treatment of First Southern's $9 million secured claim complied with the secured creditor "cram down" requirements of § 1129(b)(2)(A)(i). On appeal to the district court, the district court partially reversed the bankruptcy court's valuation of First Southern's collateral, holding that "the bankruptcy court's determination of the value of First Southern's collateral under § 506(a) should have included consideration of the value of the remaining [federal income] tax credits."[14] Otherwise, though, the district court affirmed the balance of the bankruptcy court's valuation, including the bankruptcy court's decision that the property should be valued as affordable housing property encumbered by the low-income-rent restrictive covenants.

On remand, the bankruptcy court valued the remaining tax credits for the Sunnyslope property at $1.3 million, bringing the value of First Southern's collateral to $3.9 million.[15] Under Sunnyslope's plan, therefore, treatment of First Southern's $9 million § 1111(b)(2) secured claim became: (1) First Southern would retain its lien on the apartment complex to secure payment in full of that $9 million secured claim, in accordance with Code § 1129(b)(2)(A)(i)(I), and (2) Sunnyslope would pay First Southern (a) $3.9 million, with interest, over a 40-year period, and (b) a balloon payment of the $5.1 million balance owing at the end of that 40-year term (at which time, all of the low-income-rent restrictive covenants would have expired by their terms), in accordance with Code § 1129(b)(2)(A)(i)(II). The bankruptcy court confirmed the plan, as modified to reflect the increased valuation of First Southern's collateral, again finding that the plan complied with the secured creditor cram-down requirements of § 1129(b)(2)(A)(i), and the district court affirmed that confirmation order.

On further appeal to the Ninth Circuit, a divided 3-judge panel reversed the confirmation order.[16] The majority opinion, authored by Judge Clifton, held that the bankruptcy court's valuation methodology, by assuming continued operation of the apartment complex as covenant-restricted low-income housing, was inconsistent with the so-called "replacement value" standard for valuation of collateral mandated by the Supreme Court's decision in *Rash*. Judge Paez, in dissent, argued that in actuality the majority was mandating use of the so-called "foreclosure value" standard in this particular case, which the Supreme Court specifically repudiated in *Rash*.

Sunnyslope file a motion for rehearing en banc, which was granted. On en banc rehearing, a divided en banc panel of 11 Ninth Circuit judges (by an 8-3 vote, with a short dissenting opinion authored by Judge Kozinski) ultimately sided with Judge Paez and affirmed the bankruptcy court's confirmation order.[17] First Southern has now filed a certiorari petition with the Supreme Court, so we may not have received the last word on the *Sunnyslope* valuation dispute.

The lingering disagreement and uncertainty regarding the appropriate collateral valuation in *Sunnyslope* exposes a deeper philosophical conflict

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regarding the appropriate purposes of Chapter 11 reorganization proceedings. Indeed, directly confronting that theoretical debate is the most illuminating way to understand the valuation dispute in *Sunnyslope*, as the terms of the controlling statutory provision regarding collateral valuation, and even the Supreme Court's *Rash* opinion, ultimately just beg the question. We will begin, though, by considering what guidance there is in the Code and *Rash*.

Code § 506(a) and the *Rash* Decision

The governing statutory provision regarding valuation of collateral for purposes of determining the amount of an underesecured creditor's "allowed secured claim"—entitled to payment in full, with interest, under a cram-down plan—is Code § 506(a)(1) (emphasis added):

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of *the value of such creditor's interest in the estate's interest in such property* . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. *Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property*, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

The legislative history discusses the contemplated valuation in conjunction with the parallel concept of "adequate protection" of the value of a secured creditor's lien rights:

> Secured creditors should not be deprived of the benefit of their bargain. There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws. . . . Though the creditor might not receive his bargain in kind, the purpose . . . is to insure that the secured creditor receives in value essentially what he bargained for.
>
> [This approach turns] on the value of the protected entity's interest in the property involved. The [statute] does not specify how value is to be determined, nor does it specify when it is to be determined. These matters are left to case-by-case interpretation and development. It is expected that the courts will apply the concept in light of facts of each case and general equitable principles. It is not intended that the courts will develop a hard and fast rule that will apply in every case. The time and method of valuation is not specified precisely, in order to avoid that result. There are an infinite number of variations possible in dealings between debtors and creditors, the law is continually developing, and new ideas are continually being implemented in this field. The flexibility is important to permit the courts to adapt to varying circumstances and changing modes of financing.[18]

As Professor Carlson has insightfully observed, the "subjunctive" nature of any valuation—"What would have happened if. . .?"—requires the litigants and the courts to posit a sufficiently plausible and permissible (as a matter of law) subjunctive (what-if, hypothetical) sale scenario to justify any given judicial valuation.[19] The first sentence of § 506(a)(1) and the first paragraph of the above-quoted legislative history would lead one to believe that a secured creditor's baseline distributional entitlement is the value the secured creditor could realize in a hypothetical foreclosure sale of the collateral.

In the *Rash* case, though, the Supreme Court rejected a foreclosure-sale valuation methodology when valuing collateral for purposes of confirming a cram-down plan under which the debtor proposes to keep and use the collateral. According to the *Rash* decision (no pun intended), the first sentence of § 506(a)(1) "imparts no valuation standard. A direction simply to consider the 'value of such creditor's interest' does not expressly reveal *how* that interest is to be valued."[20] "The full first sentence of § 506(a)[1] . . . tells a court what it must evaluate, but it does not say more; it is not enlightening on how to value collateral."[21]

According to the *Rash* Court (again, no pun intended), the appropriate valuation standard *is* prescribed by the second sentence of § 506(a)(1),[22] which states that "[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." "[D]eriving a foreclosure-value standard from § 506(a)[1]'s first sentence [would] render[] inconsequential the [second] sentence that expressly addresses how 'value shall be determined.' " "As we comprehend § 506(a), the 'proposed disposition or use' of the collateral is of paramount importance to the valuation question."[23]

In the cram-down context, the Court saw in the second sentence of § 506(a)(1) very specific guidance regarding the appropriate valuation methodology:

> Tying valuation to the actual "disposition or use" of the property points away from a foreclosure-value standard when a . . . debtor, invoking cram down power, retains and uses the property. Under that option, foreclosure is averted by the debtor's choice and over the creditor's objection.
>
> * * * *
>
> A replacement-value standard, on the other hand, . . . renders meaningful the key words "disposition or use."
>
> * * * *
>
> Of prime significance, the replacement-value standard accurately gauges the debtor's "use" of the property. It values "the creditor's interest in the collateral in light of the proposed [repayment plan] reality: no foreclosure sale and economic benefit for the debtor derived from the collateral equal to . . . its [replacement] value." The debtor in this case elected to use the collateral to generate an income stream. That actual use, rather than a foreclosure sale that will not take place, is the proper guide under a prescription hinged to the property's "disposition or use."[24]

And the *Rash* Court set forth several similar formulations of the subjunctive purchase transaction by which § 506(a)(1) replacement value is properly measured: "The value of property retained because the debtor has exercised the . . . 'cram down' option is the cost the debtor would incur to obtain a *like asset* for the same 'proposed . . . use,' "[25] i.e., "what the debtor would have to pay for *comparable property*."[26] "In such a "cram down' case, we hold, the value of the property (and thus the amount of the secured claim under § 506(a)[1]) is the price a willing buyer in the debtor's trade, business, or situation would pay to obtain *like property* from a willing seller,"[27] meaning "property of *like age and condition*."[28]

Rash Meets *Sunnyslope*

Rash was decided in the context of a Chapter 13 cram-down valuation. Courts have generally held, though, that *Rash*'s reasoning is also fully applicable to collateral valuations in the context of a Chapter 11 cramdown.[29] And throughout the *Sunnyslope* valuation dispute, everyone assumed that *Rash* is the controlling precedent. How *Rash* should be applied to the *Sunnyslope* case, therefore, was the bone of contention. In particular, precisely what does *Rash* mean by "like" or "comparable" property when the property at issue is burdened by restrictive covenants that reduce the value of that property? Is "like" or "comparable" property also burdened by those same restrictive covenants?

"Subordination" of the Non-HUD Restrictive Covenants

The majority opinion for the initial 3-judge Ninth Circuit panel held that *Rash* mandates valuation of the Sunnyslope apartment complex unburdened by the low-income-rent restrictive covenants. Moreover, the evidence before the bankruptcy court was undisputed that *without* those restrictive covenants, the Sunnyslope apartment complex would be worth at least $7 million, rather than the $3.9 million valuation of the bankruptcy court that assumed the continued existence of those restrictive covenants. That panel majority's rationale for assuming away the affordable housing restrictive covenants emphasized the "subordination" provision in those restrictive covenants:

> We conclude, as a matter of law, that the restrictive provisions should not apply to limit the value of First Southern's secured claim.
>
> The starting point is that First Southern as a secured creditor stands in the first position. It obtained the rights of the senior lender from HUD. HUD acquired the Capstone Loan after it fell into default, sold it to First Southern, and released First Southern from the requirements of the HUD Regulatory Agreement. First Southern's secured claim is superior to the rights of other secured creditors.
>
> All of the restrictive covenants and other provisions that Sunnyslope seeks to invoke to limit the project to affordable housing and to the reduced rental income that would be collected as a result are derived from positions that were junior and expressly subordinated to the Capstone Loan. The agreement related to the City of Phoenix loan, for instance, states that "the provisions hereof are expressly subordinate to the [Capstone] HUD insured mortgage or Deed of Trust, to the HUD Regulatory Agreement, and subordinate to all applicable HUD mortgage insurance . . . regulations and related administrative requirements." They further provided that "[i]n the

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> event of foreclosure or transfer of title by deed in lieu of foreclosure, any and all land use covenants contained herein shall automatically terminate." If there were a foreclosure sale, there is no doubt that the restrictive provisions would be swept away, giving First Southern's interest a value of at least $7 million.
>
> Due to the bankruptcy proceedings, there has not been a foreclosure sale. But that does not mean that the secured value of First Southern's secured claim may be suppressed by conditions subordinated to its position and attached to loans made by junior creditors.[30]

It is not at all clear, though, that the cited "subordination" provision entirely eviscerates the binding nature of the "subordinated" restrictive covenants (as the above-quoted passage suggests) simply because HUD chose to voluntarily release its restrictive covenants to facilitate sale of the Capstone loan to First Southern. Because the low-income-rent restrictive covenants predictably *reduce* the value of the property at issue, they are antithetical to the normal interests of lenders to *maximize* their security by maximizing the value of their collateral. The public bodies who are the beneficiaries of those restrictive covenants obviously have primarily a nonfinancial interest in enforcement of those restrictive covenants—promoting the provision of low-income housing.

One cannot necessarily assume, therefore, that "subordination," as applied to those restrictive covenants, has the same meaning and implications conventionally attached to the subordination of liens. "Subordination" in this context most likely refers principally (if not exclusively) to a means of resolving any irreconcilable conflict between the various restrictions imposed by the multiple sets of simultaneous restrictive covenants (including rent restrictions mandated by the Capstone deed of trust). Indeed, the clause immediately succeeding each of the so-called "subordination" provisions stated: "and in the event of any conflict between the provisions of this Agreement and the provisions of the National Housing Act, any applicable HUD insurance . . . regulations, related HUD administrative requirements and the [Capstone] Mortgage Loan Documents, . . . the said National Housing Act, HUD insurance . . . regulations, related administrative requirements, [and the Capstone] Mortgage Loan Documents . . . shall be controlling in all respects."[31]

To the extent the "subordination" provisions were nothing more than a means for resolving conflicts between restrictive-covenant requirements, termination of all the HUD restrictive covenants would *not* invalidate the "subordinated" restrictive covenants. Rather, it would *elevate* the enforceability of those restrictive covenants by insuring that there could no longer be any conflict between those requirements and the now-terminated HUD requirements. And the terms of the sale agreement between HUD and First Southern, explicitly advising First Southern that the property remained subject to all restrictive covenants of record, also suggest that HUD's release of its restrictive covenants, in and of itself, had no effect whatsoever on the enforceability of the "subordinated" restrictive covenants.

The Foreclosure Termination Provision of the Non-HUD Restrictive Covenants

Of course, the non-HUD restrictive covenants were also "subordinate" to the Capstone deed of trust in the sense that foreclosure of the Capstone deed of trust would completely terminate the non-HUD restrictive covenants pursuant to the terms of the foreclosure-termination provision in each of the non-HUD restrictive covenants. Because the Capstone loan was HUD-insured, any foreclosure of the Capstone deed of trust predictably would be at the instance of HUD itself or a HUD assignee, such as First Southern. In the absence of such a foreclosure, though, the non-HUD restrictive covenants continue to exist for the full term thereof, as the above-quoted passage from the 3-judge panel majority implicitly acknowledges.

The foreclosure-termination provision in the non-HUD restrictive covenants, therefore, seems designed to make foreclosure of the first-priority HUD-insured mortgage a proxy for a determination that the housing project at issue simply is not viable as a rent-restricted affordable housing property (and, thus, should no longer be encumbered by low-income-rent restrictive covenants) or, at least, leaves that determination to HUD to make. And, of course, the presumption such a proxy makes in the

absence of such a foreclosure is the opposite—the property *is* still viable as a rent-restricted affordable housing property and, thus, *should* remain fully subject to the non-HUD low-income-rent restrictive covenants.

In the *Sunnyslope* case, because HUD sold the Capstone loan rather than foreclose, HUD itself did not take the determinative step necessary to terminate the non-HUD restrictive covenants. Thus, the sale agreement between HUD and First Southern explicitly advised First Southern that the property remained subject to the non-HUD restrictive covenants. And, of course, First Southern had no interest in determining whether the property is still viable as a rent-restricted affordable housing property; First Southern's only objective from the outset was to foreclose the deed of trust in order to thereby eliminate all of the low-income-rent restrictive covenants and thereby maximize its return on investment in purchasing the Capstone loan.

Had HUD retained ownership of the Capstone loan, its ability to terminate all of the non-HUD restrictive covenants via foreclosure was nearly absolute, even in the face of a bankruptcy filing by Sunnyslope. That is because of the statutory exception to bankruptcy's automatic stay in Code § 362(b)(8), which provides that a bankruptcy filing does not stay "the commencement of any action by the Secretary of Housing and Urban Development to foreclose a mortgage or deed of trust in any case in which the mortgage or deed of trust held by the Secretary is insured or was formerly insured under the National Housing Act and covers property, or combinations of property, consisting of five or more living units." Only HUD, though, and no other holders of a HUD-insured mortgage, can take advantage of the § 362(b)(8) stay exception. HUD's sale of the Capstone loan, therefore, not only left all of the non-HUD restrictive covenants in place and fully enforceable according to their terms; HUD's sale of the Capstone loan also made it vulnerable to a restructuring in Chapter 11.

If the Sunnyslope apartment complex *were* still viable as an affordable housing property, then one would fully expect the inevitable foreclosure action by First Southern to be met with a Chapter 11 filing that then attempts to force a restructuring on First Southern via the Chapter 11 cram-down power, which of course is what actually transpired in the *Sunnyslope* case. And HUD also fully apprised First Southern of that eventuality in the terms of the sale agreement by which First Southern acquired the loan.[32]

By its sale of the Capstone loan to First Southern and release of the HUD low-income-rent restrictive covenants—while explicitly advising First Southern that (i) the Sunnyslope property remained subject to the non-HUD restrictive covenants and (ii) enforceability of the Capstone deed of trust was limited by the federal bankruptcy reorganization laws—HUD seems to have inevitably left the determination regarding whether the Sunnyslope apartment complex remains viable as low-income housing for the Chapter 11 process to resolve. And, of course, many would say that this is where such determinations *should* be made and, indeed, that making such determinations in the context of cramdown rulings is a core function of the Chapter 11 process.

One can legitimately question, therefore, the implicit assumption/suggestion of the initial 3-judge panel majority in *Sunnyslope* that the implication of the "subordination" and foreclosure-termination provisions in the non-HUD restrictive covenants, together with HUD's release of its restrictive covenants, effectively extinguished the non-HUD restrictive covenants for purposes of determining the fundamental nature of the property at issue and thus the value-relevant characteristics of "like" or "comparable" property.

That implicit assumption was embedded in the 3-judge panel majority's conception of "like" or "comparable" property for purposes of properly pricing a subjunctive replacement-value purchase transaction: "The cost to build or buy an apartment complex like Sunnyslope would be much more than the valuation of First Southern's secured claim asserted by Sunnyslope and allowed by the district court."[33] That is an appropriate conception of "like" or "comparable" property, though, only if the property being purchased in that subjunctive replacement-value purchase transaction were unburdened by the low-income-rent restrictive covenants that still encumbered the Sunnyslope property.[34]

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Release of the HUD restrictive covenants, in and of itself, had no effect on the non-HUD restrictive covenants, and a foreclosure sale of the property (that would have terminated those restrictive covenants) was predictably superseded by the Chapter 11 process. Nothing about HUD's release of its (and only its) restrictive covenants, therefore, is in any way inconsistent with conceptualizing the transaction by which Sunnyslope would acquire "like" or "comparable" property (for purposes of properly pricing that subjunctive replacement-value purchase transaction) as purchase of an apartment complex of "like age and condition" that is subject to the same low-income-rent restrictive covenants as those still burdening the Sunnyslope property.

To conclude that the restrictive covenants still burdening the Sunnyslope property are *not* a value-relevant characteristic of "like" or "comparable" property (for purposes of properly pricing a subjunctive replacement-value purchase transaction), one must conclude that the bankruptcy process *must* eliminate those restrictive covenants in order to maximize creditors' recoveries. That is a very controversial proposition, though, which raises longstanding philosophical disagreements about the proper purpose and function of Chapter 11. Finding an answer to that philosophical question in *Rash* is difficult because the *Rash* opinion is famously inconsistent and incoherent in its reasoning.

Rash *as Foreclosure Value Plus a Bonus Cushion*

The position of First Southern is that the Sunnyslope property must be valued for cram-down purposes as if the property were unburdened by the affordable-housing restrictive covenants. As Judge Kozinski pointed out, on the unique facts of *Sunnyslope*, that approach to valuation would produce a replacement-value that closely resembles (and seems indistinguishable from) the foreclosure value of the property.[35] Moreover, there is some support in the *Rash* opinion for using the foreclosure value on the unique facts of *Sunnyslope*. In the more typical case where replacement value *exceeds* foreclosure value (which was the case in *Rash*), the Court justified the *higher* replacement-value standard, inter alia, by pointing to the risks imposed on the creditor by the debtor's retention of the collateral and deferred payment to the creditor, in the following "curious (and troubling) passage"[36] from the *Rash* opinion:

> From the creditor's perspective . . . surrender and retention are not equivalent acts.
>
> When a debtor surrenders the property, a creditor obtains it immediately, and is free to sell it and reinvest the proceeds. We recall here that [the secured creditor] sought that very advantage. If a debtor keeps the property and continues to use it, the creditor obtains at once neither the property nor its value and is exposed to double risks: The debtor may again default and the property may deteriorate from extended use. Adjustments in the interest rate . . . do not fully offset these risks.[37]

As Justice Stevens' dissent in *Rash* pointed out, though, the statutory design is evidently to compensate the secured creditor for this risk through the risk-premium component of a cram-down interest rate and *not* through a cushion in the collateral valuation.[38] If the cram-down interest rate is set at a level that appropriately compensates the secured creditor for the "double risks" cramdown imposes, the "effect of artificially inflating the initial valuation of collateral will be to *over*-compensate the secured creditor, who will in effect have been paid twice for both the default risk and the depreciation risk."[39] Perhaps unsurprisingly, therefore, when the Court subsequently considered the appropriate cram-down interest rate in the *Till* case,[40] there was no majority opinion and the "holding" of the case (to the extent one can discern what that is, which is challenging) is highly ambiguous as to whether the cram-down interest rate should seek to compensate secured creditors for the "double risks" identified in *Rash*. Indeed, "the disconnect between *Rash* and *Till* leaves us without any principled means for assessing whether secured creditors are being overcompensated or undercompensated in cramdown"[41] or even what their baseline cram-down compensation right is compensating them for.

Most importantly, for purposes of the *Sunnyslope* decision, *Rash*'s "double risks" passage raises the possibility that a secured creditor's baseline distributional entitlement in cram-down is, in actuality, *foreclosure* value of its collateral. Thus, the argument goes, the *Rash* Court mandated use of a replacement-value standard not because the statute mandates replacement value, as such, but

rather as a means of ensuring that, at a minimum, secured creditors recover their foreclosure value. The "double risks" passage justifies replacement value as a sort of valuation "bonus" to make up for what otherwise would be systematic under-compensation relative to the foreclosure-value baseline.

If that is the significance of the *Rash* "double risks" passage, then First Southern's collateral should have been valued at its higher foreclosure value, since the valuation cushion "bonus" of replacement value would produce *no* significant (if any) additional value on the unique facts of *Sunnyslope*. And both the initial 3-judge panel majority and Judge Kozinski, in his en banc dissent, emphasized *Rash*'s "double risks" comment in concluding that a "valuation [that] falls well below what the secured creditor would obtain from an immediate sale" is inconsistent with *Rash*.[42] Of course, to reach that conclusion, one has to seriously discount (if not totally disregard) the *Rash* Court's determination (which the Court itself characterized as the consideration of "prime significance" and "paramount importance") that the text of the statute *mandates* a replacement-value standard when a "debtor, invoking cram down power, retains and uses the property" because "[t]hat actual use, rather than a foreclosure sale that will not take place, is the proper guide under a [statutory] prescription hinged to the property's 'disposition or use.' "[43]

When faced, therefore, with the potential conflict (nicely exposed by the unique facts of *Sunnyslope*) between (i) what *Rash* cast as a textual mandate for a replacement-value standard and (ii) a "foreclosure-value plus" standard derived from *Rash*'s " 'double risks' gaffe,"[44] the safer bet may well be to disregard the "double risks" comment as a throw-away subsidiary justification that was ill-considered and entirely unnecessary to the *Rash* holding. And, of course, that is essentially what the en banc Ninth Circuit majority did.

Could Sunnyslope Confirm a Plan "Free and Clear" of the Non-HUD Restrictive Covenants?

If *Rash* mandates a replacement-value standard, even on the facts of *Sunnyslope*, we must still determine whether the non-HUD affordable-housing restrictive covenants that encumber the Sunnyslope property are properly considered a feature of "like" or "comparable" property for purposes of pricing a subjunctive replacement-value purchase transaction. The initial 3-judge panel majority and Judge Kozinsky's en banc dissent took the position that "like" or 'comparable" property should be hypothesized as property unburdened by such affordable-housing restrictive covenants. Judge Paez's dissent from the 3-judge panel decision and the en banc Ninth Circuit decision, however, concluded that "like" or "comparable" property should be property subject to such affordable-housing restrictive covenants. By what means, though, should we determine whether those affordable-housing restrictive covenants should or should not be included as a subjunctive feature of replacement-value "like" or "comparable" property?

One place to start would be to simply consider whether the bankruptcy process can, in fact, eliminate or nullify the enforceability of those restrictive covenants. If it is beyond the power of a federal bankruptcy court, using the judicial processes and remedies at its disposal under the Bankruptcy Code, to expunge those restrictive covenants and thereby render them unenforceable, it would seem that the fundamental nature of the property Sunnyslope was proposing to retain and use via its cram-down plan (and that we would need to price in a subjunctive replacement-value purchase transaction) is property subject to those same low-income-rent restrictive covenants. Indeed, a critical unstated assumption behind any cram-down valuation that disregards those restrictive covenants would seem to be that Sunnyslope *could* indeed confirm a plan of reorganization that freed its property from those restrictive covenants. The validity of that assumption, though, was never explored by either the 3-judge panel majority or Judge Kozinski's en banc dissent.

That is a nontrivial concern because the courts have generally construed "recorded restrictive covenants, easements and other so-called 'equitable servitudes' that run with the land"[45] to be immune from bankruptcy's "free and clear" provisions, whether via the free-and-clear sale power of Code § 363(f) or the free-and-clear vesting power of a

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confirmed plan of reorganization under Code § 1141(c).[46] The latter provision, in particular, is only applicable to the property "interests" of "creditors" with a monetary "right to payment."[47]

> Because the beneficiaries of [nonmonetary] restrictive covenants could insist upon compliance with such covenants via injunctive relief and could not be compelled to accept a big pile of money in lieu of their right to injunctive relief, [a confirmed plan cannot vest property subject to such restrictive covenants in the reorganized debtor or a purchaser of the property] free and clear of such restrictive covenants. . . . Bankruptcy only deals with a debtor's monetary obligations—those which the debtor could satisfy through a monetary payment.[48]

Indeed, one of the first cases to establish that principle under the Bankruptcy Code dealt with low-income-housing restrictive covenants.[49]

Of course, the non-HUD restrictive covenants at issue in *Sunnyslope* are somewhat unique in that they explicitly provide, by their own terms, that they are terminated in any foreclosure sale of the property at issue. This seems to be precisely the kind of circumstance that Code § 363(f)(1) contemplates in providing that a trustee or DIP can sell property of the estate "free and clear of any interest . . . if applicable nonbankruptcy law permits sale of such property free and clear of such interest." Presumably, therefore, a bankruptcy sale of the Sunnyslope property could replicate the effects of a nonbankruptcy foreclosure sale of that property and thereby terminate the non-HUD restrictive covenants.

Sunnyslope, though, was not proposing a sale of the property. Sunnyslope was proposing to retain and use that property via confirmation of a plan of reorganization, and the § 1141(c) confirmation free-and-clear provision contains no counterpart to § 363(f)(1). It is extremely unclear, therefore, whether Sunnyslope could have confirmed a plan that simultaneously allowed it to retain and continue to use the property at issue *and* that invalidated the non-HUD restrictive covenants. Indeed, "[t]here is little (if any) case law dealing with divesting restrictive covenants through a plan pursuant to the free-and-clear language of § 1141."[50]

Simply assuming, therefore, that the nature of the property Sunnyslope was proposing to retain and use via its cram-down plan was property *without* the low-income-rent restrictive covenants at issue seems entirely unjustified. And that assumption is particularly unjustified given that it was never tested via the adversarial process, with notice to the governmental entities that are the beneficiaries of those restrictive covenants and with an opportunity for them to object to a proposed invalidation of those restrictive covenants.

Must Sunnyslope Confirm a Plan "Free and Clear" of the Non-HUD Restrictive Covenants?: Herein of Chapter 11's Raison d'Etre

Even if it were safe to assume that Sunnyslope *could* confirm a plan "free and clear" of the non-HUD restrictive covenants, again, that is *not* what Sunnyslope's plan proposed to do. There is nothing in either § 363(f) or § 1141(c) that *mandates* disposition of estate property "free and clear" of any and all "interests" in that property. In the discretion of the estate representative, a § 363 sale can be made subject to particular interests. And the § 1141(c) vesting provision explicitly provides that "the property dealt with by the plan" is *not* "free and clear of all claims and interests" to the extent "otherwise provided in the plan or in the order confirming the plan."

The other critical assumption behind any cram-down valuation that disregards the non-HUD restrictive covenants, therefore, is the unstated premise that, in order to confirm a plan of reorganization, Sunnyslope *must* propose a plan that frees its property from those restrictive covenants; the option to propose a plan subject to those restrictive covenants simply should not have been available to Sunnyslope. Judge Kozinski's en banc dissent reveals the centrality of that assumption in the following passage:

> Even though the [*Rash*] Court has told us that cramdown valuations are supposed to limit a secured creditor's risk, we've adopted a new valuation standard that turns entirely on the debtor's desires—creditors be damned. Instead of holding the valuation hostage to the debtor's "particular use," I would hold that the appropriate value is the market price of the building without restrictive covenants.[51]

And why should Sunnyslope be denied the ability to propose a plan that leaves its property subject

to the non-HUD restrictive covenants, when the text of the Code seems to leave that choice to the plan proponent? The intuition behind that reaction is revealed by Judge Kozinski's "creditors be damned" comment. If we assume that the *only* legitimate purpose of Chapter 11 is to maximize creditor recoveries, then it is hard to swallow confirmation of a plan that clearly does *not* maximize the recovery of the only creditor of any consequence in *Sunnyslope*—First Southern. A cramdown valuation that ignores the value-reducing restrictive covenants encumbering the property, therefore, is an oblique prohibition against a proposed use of that property that does not maximize First Southern's recovery.

That approach to the *Sunnyslope* valuation issue, though, invites familiar theoretical objections to the normative premise that the *only* legitimate objective of Chapter 11 is maximizing creditor recoveries. One such objection focuses upon noncreditor interests that are advanced via successful reorganization of a debtor's business via Chapter 11:

> Others note that [a] narrow focus on creditor wealth maximization ignores the widespread effects of a business failure on those without any formal right to distribution from the debtor's assets, such as employees, suppliers, customers, and the larger community in which the debtor's business operates. Efforts at reorganization and accompanying redistributions that might be considered inefficient from the standpoint of maximizing . . . creditor distributions may nonetheless be desirable for the purpose of protecting these non-creditor and community interests.[52]

In the *Sunnyslope* case, the obvious and important non-creditor interest at stake with confirmation (or not) of Sunnyslope's plan is whether the Sunnyslope apartment complex will continue to be operated as low-income housing.[53] The direct beneficiaries of that non-creditor interest (current and future low-income tenants of the property) have no means of voicing their interests through the judicial processes of a Chapter 11 reorganization. Their interests can be advanced only indirectly, e.g, by the governmental entities that are the named beneficiaries of the non-HUD restrictive covenants, which the creditor-wealth-maximization approach to the *Sunnyslope* valuation issue simply ignores, as discussed above.

In addition, though, the interest of low-income tenants of the Sunnyslope apartment complex is also advanced "by those parties with a direct financial stake, seeking to enhance their returns."[54] In *Sunnyslope*, that role was assumed by the owners of the Sunnyslope property (including new equity investors), who obviously believed that their financial returns would be maximized by continuing to own and operate the Sunnyslope property as low-income housing. The inevitable conflict that poses between the interests of creditors and those of a debtor's owners is not, by any means, unique to the *Sunnyslope* case; it is endemic to single-asset real estate cases such as *Sunnyslope* and "the core, recurring single-asset balance-of-power struggle between debtor and secured creditor."[55] Indeed, single-asset real estate cases seem to be a prime illustration of the positive truism that our Chapter 11 system does seek to implement objectives other than simply maximization of creditor recoveries:

> Given that Congress seems to have intended to permit single-asset real estate cases, and given that single-asset real cases also seem inconsistent with the standard story about why we have Chapter 11, that seems to indicate that the standard story is an oversimplification that is incomplete. Bankruptcy actually functions to serve a broader range of purposes than the standard story would lead one to believe, and leveling the playing field for the debtor in negotiating a restructuring of secured debt *is* one of the principal functions of Chapter 11 reorganizations. Implicit in the single-asset real estate cases is the idea that bankruptcy *does* give the debtor's equity holders a second chance to try to make a go of it and make some money, despite a state-law default under the mortgage that gives the secured creditor a state-law right to wipe out the debtor's equity interest through foreclosure. If the secured creditor will not agree to a restructuring of the mortgage debt, then the debtor may be able to impose a restructuring on the secured creditor through Chapter 11, as long as that restructuring complies with the Code's cram-down provisions and is approved by the bankruptcy court.[56]

One can also legitimately question, therefore, the validity of the normative creditor-wealth-maximization assumption embedded in the cramdown valuation methodology advocated by the *Sunnyslope* 3-judge panel majority and Judge Kozinsky's en banc dissent.

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A Secured Creditor's Best-Interests Right to Receive at Least Liquidation Value

Of course, to say that Chapter 11 implements policy objectives other than maximizing creditor recoveries is not to say that Chapter 11 pursues such policies at all costs. Protecting creditors' recovery rights obviously *is* a (if not the) principal objective of Chapter 11. In that regard, one of the fundamental inviolable protections available to each and every creditor of a Chapter 11 debtor is the right to recover at least as much as that creditor would receive if the debtor were liquidated in a Chapter 7 proceeding. That protection, though, is not implemented via the cram-down protections of § 1129(b); it is implemented via the best-interests test of § 1129(a)(7).

The best-interests protection of § 1129(a)(7) provides that a plan can be confirmed only if the following is true:

> (7) With respect to each impaired class of claims . . .
>
> (A) each holder of a claim . . . of such class—
>
> (i) has accepted the plan; or
>
> (ii) will receive or retain under the plan on account of such claim . . . property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date . . . .

As discussed above, § 363(f)(1) presumably authorizes a sale of the Sunnyslope property free and clear of the value-inhibiting non-HUD restrictive covenants. In a Chapter 7 liquidation, therefore, a Chapter 7 trustee undoubtedly would opt to sell the Sunnyslope property free and clear of the non-HUD restrictive covenants. First Southern, therefore, could have protected its right to receive at least the foreclosure value of its collateral via a § 1129(a)(7)(A) objection to confirmation of Sunnyslope's plan.

First Southern, however, waived its guaranteed right to recover, at a minimum, foreclosure value of its collateral by electing § 1111(b)(2) treatment of its allowed secured claim. Code § 1129(a)(7)(B) provides that a plan can be confirmed if:

> (7) With respect to each impaired class of claims . . .
>
> . . .
>
> (B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property *of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property* that secures such claim.

The above-italicized language exactly replicates the language of a secured creditor's cram-down protection under Code § 1129(b)(2)(A)(i)(II), guaranteeing that an undersecured creditor must receive no less than the value of the secured creditor's collateral, with interest. For an objecting secured creditor opting for § 1111(b)(2) treatment, therefore, § 1129(a)(7) provides *no* additional protection, over and above that already provided by cram-down requirements. As the legislative history explains:

> Section 1129(a)(7)[C] in effect exempts creditors making an election under section 1111(b)(2) from application of the best interests of creditors test . . . [s]ince section 1129(b)(2)(A) [already] makes clear that an electing class need receive payments of a present value only equal to the value of the collateral.[57]

In *Sunnyslope*, therefore, the differential between the lower replacement value of the Sunnyslope property (encumbered by the value-diminishing non-HUD restrictive covenants) and the higher foreclosure value of that property (freed from those restrictive covenants) presented First Southern with a strategic choice: (1) insist upon best-interests protection in order to receive at least the $7 million foreclosure value of its collateral, with interest, under Sunnyslope's plan, or (2) waive best-interests protection by making the § 1111(b)(2) election and thereby retain a lien on the Sunnyslope property that, in the event of a future plan default by Sunnyslope, (a) would secure the full amount of First Southern's allowed claim of $9 million and (b) would allow First Southern to realize the higher foreclosure value of the Sunnyslope property (freed from the value-reducing non-HUD restrictive covenants) in a foreclosure sale upon default. As the legislative history explained:

> The advantage to the electing creditors is that they have a lien securing the full amount of the allowed claim . . . . Thus it is both reasonable and necessary to exempt such electing class from application of section 1129(a)(7) as a logical consequence of permitting election under section 1111(b)(2).[58]

The right to recover the higher foreclosure value

of its collateral that First Southern sought in the *Sunnyslope* case was, therefore, fully available to First Southern via best-interests protection. That fact weakens considerably the claim that cramdown must *also* incorporate a similar protection, through an adjusted understanding of *Rash*'s cramdown collateral-valuation standard, even on the unusual facts of *Sunnyslope*.

ENDNOTES:

[1]In re Sunnyslope Housing Limited Partnership, 859 F.3d 637, 64 Bankr. Ct. Dec. (CRR) 51, 77 Collier Bankr. Cas. 2d (MB) 1338, 77 Collier Bankr. Cas. 2d (MB) 1670, Bankr. L. Rep. (CCH) P 83115 (9th Cir. 2017), as amended, (June 23, 2017).

[2]In re Sunnyslope Housing Ltd. P'ship, 818 F.3d 937 (9th Cir. 2016), rev'd, 859 F.3d 637 (9th Cir. 2017) (en banc).

[3]Associates Commercial Corp. v. Rash, 520 U.S. 953, 117 S. Ct. 1879, 138 L. Ed. 2d 148, 30 Bankr. Ct. Dec. (CRR) 1254, 37 Collier Bankr. Cas. 2d (MB) 744, Bankr. L. Rep. (CCH) P 77409 (1997).

[4]Docket No. 75-2 at 90, In re Sunnyslope Ltd. P'ship, No. 2:11-cv-2579-HRH, 2012 WL 12949503 (D. Ariz. Sept. 8, 2012).

[5]In re Sunnyslope Housing Ltd. P'ship, 2012 WL 12949503, at *1 (D. Ariz. 2012), aff'd, 859 F.3d 637 (9th Cir. 2017) (en banc), vacating 818 F.3d 937 (9th Cir. 2016).

[6]"[T]he provisions hereof are expressly subordinate to the [Capstone] HUD insured mortgage or Deed of Trust, to the HUD Regulatory Agreement, and subordinate to all applicable HUD mortgage insurance . . . regulations and related administrative requirements." Sunnyslope, 2012 WL 12949503, at *2.

[7]"In the event of foreclosure or transfer of title by deed in lieu of foreclosure, any and all land use covenants herein shall automatically terminate." Sunnyslope, 2012 WL 12949503, at *2.

[8]"The provisions of this Agreement are expressly subordinate to the [Capstone] Senior Loan, to the HUD Regulatory Agreement, and subordinate to all applicable HUD mortgage insurance . . . regulations and related administrative requirements." Sunnyslope, 2012 WL 12949503, at *2.

[9]"[I]n the event of foreclosure or transfer by title of deed in lieu of foreclosure, any and all land use covenants contained in this Agreement shall automatically terminate." Sunnyslope, 2012 WL 12949503, at *2.

[10]"[T]he provisions hereof are expressly subordinate to the [Capstone] HUD insured mortgage or Deed of Trust, to the HUD Regulatory Agreement, and subordinate to all applicable HUD mortgage insurance . . . regulations and related administrative requirements." Sunnyslope, 2012 WL 12949503, at *3.

[11]"In the event of foreclosure or transfer of title by deed in lieu of foreclosure, any and all land use covenants herein shall automatically terminate." Sunnyslope, 2012 WL 12949503, at *3.

[12]Sunnyslope, 2012 WL 12949503, at *3.

[13]Sunnyslope, 2012 WL 12949503, at *4 (quoting bankruptcy court ruling).

[14]Sunnyslope, 2012 WL 12949503, at *11.

[15]In re Sunnyslope Housing Ltd. Partnership, 2012 WL 6479735 (Bankr. D. Ariz. 2012).

[16]In re Sunnyslope Housing Ltd. Partnership, 818 F.3d 937, 62 Bankr. Ct. Dec. (CRR) 136, 75 Collier Bankr. Cas. 2d (MB) 818, Bankr. L. Rep. (CCH) P 82970 (9th Cir. 2016), as amended on denial of reh'g, (Apr. 21, 2016) and reh'g en banc granted, 838 F.3d 975 (9th Cir. 2016) and on reh'g en banc, 859 F.3d 637, 64 Bankr. Ct. Dec. (CRR) 51, 77 Collier Bankr. Cas. 2d (MB) 1338, 77 Collier Bankr. Cas. 2d (MB) 1670, Bankr. L. Rep. (CCH) P 83115 (9th Cir. 2017), as amended, (June 23, 2017).

[17]In re Sunnyslope Housing Limited Partnership, 859 F.3d 637, 64 Bankr. Ct. Dec. (CRR) 51, 77 Collier Bankr. Cas. 2d (MB) 1338, 77 Collier Bankr. Cas. 2d (MB) 1670, Bankr. L. Rep. (CCH) P 83115 (9th Cir. 2017), as amended, (June 23, 2017).

[18]S. Rep. No. 95-989, at 54 (1978); H.R. Rep. No. 95-595, at 339 (1977).

[19]David Gray Carlson, Car Wars: Valuation Standards in Chapter 13 Bankruptcy Cases, 13 Bankr. Dev. J. 1, 18 (1996). See also David Gray Carlson, Secured Creditors and the Eely Character of Bankruptcy Valuations, 41 Am. U. L. Rev. 63 (1991).

[20]Rash, 520 U.S. at 961.

[21]Rash, 520 U.S. at 961.

[22]"The second sentence of § 506(a)[1] does speak to the how question." Rash, 520 U.S. at 961.

[23]Rash, 520 U.S. at 962.

[24]Rash, 520 U.S. at 962-63 (citations omitted) (quoting In re Winthrop Old Farm Nurseries, Inc., 50 F.3d 72, 75, 26 Bankr. Ct. Dec. (CRR) 1191, 33 Collier Bankr. Cas. 2d (MB) 113, Bankr. L. Rep. (CCH) P 76426 (1st Cir. 1995)).

[25]Rash, 520 U.S. at 965 (emphasis added).

[26]Rash, 520 U.S. at 955 (emphasis added).

[27]Rash, 520 U.S. at 960 (emphasis added).

[28]Rash, 520 U.S. at 959 n.2 (emphasis added).

[29]See, e.g., In re Heritage Highgate, Inc., 679 F.3d 132, 140-42, 56 Bankr. Ct. Dec. (CRR) 145, Bankr. L. Rep. (CCH) P 82313 (3d Cir. 2012).

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[30]Sunnyslope, 818 F.3d at 946.

[31]Docket No. 75-2 at 90, In re Sunnyslope Ltd. P'ship, No. 2:11-cv-2579-HRH, 2012 WL 12949503 (D. Ariz. Sept. 8, 2012) (Phoenix IDA restrictive covenants). Accord id., Docket No. 75-2 at 54 (Phoenix Housing restrictive covenants); id., Docket No. 75-2 at 69 (Arizona Housing restrictive covenants); id., Docket No. 76-13 at 393 (Tax Credit restrictive covenants)

[32]Docket No. 76-1 at 265, In re Sunnyslope Ltd. P'ship, No. 2:11-cv-2579-HRH, 2012 WL 12949503 (D. Ariz. Sept. 8, 2012) ("subject to and as may be limited by any applicable bankruptcy [or] reorganization . . . laws . . . [the Capstone] Mortgage is a valid and enforceable lien").

[33]Sunnyslope, 818 F.3d at 947.

[34]See Sunnyslope, 859 F.3d at 648 & n.1 (Kozinski, C.J., dissenting) ("I would hold that the appropriate value is the market price of the building without restrictive covenants," and "[i]n this case, the price a buyer would have to pay on the market for like property" without those restrictive covenants "may be closely approximated by 'foreclosure value.' ")

[35]See supra note 34.

[36]Charles Jordan Tabb, The Law of Bankruptcy § 7.29, at 739 (4th ed. 2016).

[37]Rash, 520 U.S. at 962 (citations omitted).

[38]See Rash, 520 U.S. at 966 n.* (Stevens, J., dissenting).

[39]Tabb, The Law of Bankruptcy, § 7.29, at 735.

[40]Till v. SCS Credit Corp., 541 U.S. 465, 124 S. Ct. 1951, 158 L. Ed. 2d 787, 43 Bankr. Ct. Dec. (CRR) 2, 51 Collier Bankr. Cas. 2d (MB) 642, Bankr. L. Rep. (CCH) P 80099 (2004).

[41]Ralph Brubaker, Cramdown Interest Rates: Disarray Dominates Till. . .?, 24 Bankr. L. Letter No. 8, at 1, 12 (Aug. 2004).

[42]Sunnyslope, 859 F.3d at 649 (Kozinski, C.J., dissenting). See also Sunnyslope, 818 F.3d at 947-48.

[43]Rash, 520 U.S. at 962-63.

[44]Tabb, The Law of Bankruptcy, § 7.29, at 740.

[45]Risa Lynn Wolf-Smith, Shedding Burdensome Restrictive Covenants in Real Estate Sales, 33 Am. Bankr. Inst. J. No.11, at 30, 30 (Nov. 2014).

[46]See generally George W. Kuney, Further Misinterpretation of Bankruptcy Code § 363(f): Elevating In Rem Interests and Promoting the Use of Property Law to Bankruptcy-Proof Real Estate Developments, 76 Am. Bankr. L.J. 289 (2002); Basil H. Mattingly, Sale of Property of the Estate Free and Clear of Restrictions and Covenants in Bankruptcy, 4 Am. Bankr. Inst. L. Rev. 431 (1996).

[47]See 11 U.S.C.A. § 101(10) & (5).

[48]Ralph Brubaker, Successor Liability and Bankruptcy Sales: Free and Clear of What?, 23 Bankr. L. Letter No. 6, at 6, 10 (June 2003).

[49]See In re 523 East Fifth Street Housing Preservation Development Fund Corp., 79 B.R. 568 (Bankr. S.D. N.Y. 1987).

[50]Mark Pfeiffer, Will the Pipeline Continue to Flow After Sabine?, 35 Am. Bankr. Inst. J. No. 7, at 38, 39 n.12 (July 2016).

[51]Sunnyslope, 859 F.3d at 648 (Koziniski, C.J., dissenting).

[52]Ralph Brubaker, Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations, 1997 U. Ill. L. Rev. 959, 1014-15.

[53]See generally Sheryl A. Kass, Note, Bankruptcy and Low Income Housing: Where Is the Voice of the Tenants?, 22 Emory Bankr. Dev. J. 261 (2005).

[54]Brubaker, 1997 U. Ill. L. Rev. at 1032.

[55]Ralph Brubaker, Artificial Impairment and the Single-Asset Real Estate Debtor, 33 Bankr. L. Letter No. 4, at 1, 9 (Apr. 2013).

[56]Brubaker, 33 Bankr. L. Letter No. 4, at 8.

[57]124 Cong. Rec. S17,421-22 (daily ed. Oct. 6, 1978) (remarks of Sen. DeConcini); 124 Cong. Rec. H11,105 (daily ed. Sept. 28, 1978) (remarks of Rep. Edwards).

[58]124 Cong. Rec. S17,421-22 (daily ed. Oct. 6, 1978) (remarks of Sen. DeConcini); 124 Cong. Rec. H11,105 (daily ed. Sept. 28, 1978) (remarks of Rep. Edwards).

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Non-Debtor Substantive Consolidation

Hon. Maureen A. Tighe
United States Bankruptcy Judge
Central District of California

Bankruptcy Law Letter

MARCH 2017 | VOLUME 37 | ISSUE 3

Non-Debtor Substantive Consolidation—A Remedy Built on Rock or Sand?

By Kara Bruce

Substantive consolidation "is no mere instrument of procedural convenience."[1] This remedy, a creature of equity, pools the assets and liabilities of several related entities into a single bankruptcy estate, wiping out inter-company debts and satisfying all claims from a common pool of assets. It has the power to radically rebalance the rights of the consolidated entities' creditors, forcing creditors of a more solvent debtor to share with those of a less solvent affiliate.[2] This broad power is even more sweeping when courts use it to draw non-debtors into the bankruptcy process.[3]

Courts have declared substantive consolidation of non-debtor entities to be "a type of relief fraught with conceptual problems."[4] Its position "betwixt and between"[5] a variety of substantive rights makes it difficult to accurately characterize the remedy, much less define its scope. As such, courts are divided on whether, and under what circumstances, equitable principles can extend bankruptcy's reach to the assets of a non-debtor entity.

This issue of the Bankruptcy Law Letter considers the recent substantive consolidation decisions arising from the bankruptcy case of the Archdiocese of Saint Paul and Minneapolis.[6] Both the Bankruptcy and District Courts for the District of Minnesota refused to permit substantive consolidation of non-debtor parishes and other affiliates operating under the umbrella of the Archdiocese.[7] Both courts held that substantive consolidation was an impermissible exercise of the court's powers under § 105 of the Bankruptcy Code, because the attempted consolidation directly contravened § 303(a)'s prohibition on commencing an involuntary bankruptcy case against "a corporation that is not a moneyed, business, or commercial corporation."[8]

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This case provides a welcome opportunity to examine the concept of non-debtor substantive consolidation—its origins and its relation to involuntary bankruptcy—and to highlight a new (or more accurately, *old*) statutory foundation for the doctrine. I should emphasize at the outset that the analysis that follows makes no attempt to alter the outcome of the *Archdiocese* case. Both courts also held the facts alleged were insufficient to justify the extreme remedy of substantive consolidation. That holding makes good sense and should withstand any recharacterization of the doctrine itself.

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The Basics of Substantive Consolidation

Substantive consolidation has no express statutory basis in the Bankruptcy Code.[9] It is typically justified by reference to § 105[10] and a long line of pre-Code case law.[11] As the Second Circuit has stated:

> The power to consolidate is one arising out of equity, enabling a bankruptcy court to disregard separate corporate entities, to pierce their corporate veils in the usual metaphor, in order to reach assets for the satisfaction of debts of a related corporation.[12]

The standards for granting substantive consolidation vary by jurisdiction,[13] but courts tend to award the relief: (1) where the related entities' affairs are so intertwined that it would be more costly to untangle them; (2) where creditors relied on the collective credit of the group; (3) where one entity's assets have been misappropriated by a related entity; or (4) where the entities are "alter-egos" of one another.[14] The analysis is extremely fact-driven, and courts apply the tests with less than perfect fidelity.[15] As such, past case law has little predictive power in any individual case.[16]

Despite its potential impact on creditor recoveries, substantive consolidation of debtors in bankruptcy is widely accepted and, according to some accounts, growing in prominence.[17] By contrast, it is a more controversial undertaking to consolidate a debtor estate with a non-debtor affiliate. Some courts will permit substantive consolidation in limited circumstances.[18] In theory, these courts follow the same standards applicable to consolidating the estates of related debtors. But in practice—because of the potential impact of consolidation on a non-debtor and its creditors—most courts restrict non-debtor substantive consolidation to cases that demonstrate fraud or disregard of the corporate form.[19]

Other courts have concluded that non-debtor

substantive consolidation is not permitted at all.[20] Courts and commenters have stressed that § 105 is not a source of substantive rights and have identified a number of concerns—jurisdictional,[21] due-process-related,[22] and practical[23]—with applying § 105 to draw non-debtors into a bankruptcy case.[24]

A chief concern is that non-debtor substantive consolidation works an end run around the stringent requirements for involuntary bankruptcy contained in § 303 of the Code. By design, § 303 is "not user-friendly."[25] It contains a number of procedural hurdles that creditors must follow to successfully mount an involuntary petition.[26] The consequences for an unjustified involuntary petition are significant, to account for the enormous impact involuntary bankruptcy can have on the targeted debtor's business.[27] Taken together, these procedural requirements and penalties protect non-debtor entities from the capricious use of involuntary bankruptcy by disgruntled creditors. Courts are rightfully wary of employing an equitable remedy that arguably achieves an identical goal—drawing non-debtors into a bankruptcy case—without the protections of § 303.

In the *Archdiocese* case, the tension between substantive consolidation and involuntary bankruptcy arose with particular force. Section 303(a) of the Code prohibits the filing of an involuntary bankruptcy case against "a corporation that is not a moneyed, business, or commercial corporation."[28] This provision protects "[e]leemosynary institutions, such as churches, schools, and charitable organizations and foundations" from entering the bankruptcy process against their will.[29] Yet it was precisely these types of entities that the creditors' committee sought to bring into the bankruptcy case through substantive consolidation.[30] The next section explains why the bankruptcy court and the district court held that this result was an impermissible exercise of the court's equitable authority.

Substantive Consolidation as Involuntary Bankruptcy: The *Archdiocese* Approach

In January 2015, the Archdiocese of Saint Paul and Minneapolis filed for chapter 11 bankruptcy relief, becoming the 12th Catholic Archdiocese to seek bankruptcy protection to address liability for clergy sex abuse claims.[31] A major issue of contention in the *Archdiocese* case, like many other Catholic archdiocese bankruptcy cases, is the extent of the assets set aside to satisfy tort claims.[32] In this case, the Archdiocese's initial plan of reorganization pledged roughly $65 million to satisfy abuse claimants.[33] Victims' lawyers vigorously contended the Archdiocese had over $1 billion in assets, held by separately incorporated entities, that should be used to satisfy claims.[34]

Shortly before the debtor filed its plan, the official committee of unsecured creditors filed a motion to substantively consolidate the Archdiocese with over 200 separately incorporated entities.[35] This motion sought to make the assets of a large number of parishes, schools, cemeteries, and other affiliates available to satisfy claims for sexual abuse. The creditors' committee asserted that the 200-some affiliates subject to the motion functioned as a single entity under the financial and operational control of the Archdiocese.[36] The committee highlighted instances of lack of corporate independence, intermingling of assets, and inter-corporate guarantees. It also asserted that it would be nearly impossible to untangle the interrelated assets and liabilities and to allocate liability for the sex abuse lawsuits.[37]

The Archdiocese, together with a number of its targeted subsidiaries, argued in response[38] that the creditors' committee lacked standing to bring the motion, the bankruptcy court's equitable powers under § 105(a) do not permit substantive consolidation of a debtor with non-debtors, and that even if substantive consolida-

tion were permitted, the creditors' committee failed to plead facts sufficient to justify substantive consolidation in this case. Opponents to the motion also advanced arguments based on the First Amendment and Religious Freedom Restoration Act (RFRA).

Judge Robert Kressel of the Bankruptcy Court for the District of Minnesota denied the motion for substantive consolidation.[39] The court explained that § 105, the usual statutory hook for awarding substantive consolidation, cannot be exercised in a way that contravenes other statutory provisions.[40] The court then found that substantive consolidation of the non-debtor entities "squarely implicat[ed]" § 303 of the Code, which governs involuntary bankruptcy proceedings.[41] As the entities targeted for consolidation were ineligible for involuntary bankruptcy under § 303(a), the court refused to permit their consolidation under § 105.[42]

The court further held that the committee failed to allege facts to support substantive consolidation. The standard set out by the Eighth Circuit considers:

1) "the necessity of consolidation due to the interrelationship among the debtors";

2) "whether the benefits of consolidation outweigh the harm to creditors"; and

3) "prejudice resulting from not consolidating the debtors."[43]

The court held that none of these factors were met. Although "[t]here is no doubt that the Catholic Church is hierarchical in its organization and authoritarian in doctrinal matters," the committee had failed to allege facts to show that the entities were so interrelated as to require consolidation.[44] The facts alleged likewise failed to show that the benefits of consolidation outweighed the harm to creditors,[45] or that consolidation was necessary to avoid some prejudice.[46] The court did not reach the First Amendment and RFRA arguments.[47]

On appeal, the District Court affirmed.[48] The court rejected the creditors' committee attempts to distinguish substantive consolidation from involuntary bankruptcy, holding that "substantive consolidation of a charitable organization against its will equates to forcing the entity into involuntary bankruptcy" in violation of "an explicit mandate of the Bankruptcy Code."[49] The court also affirmed the lower court's alternative holding that the creditors' committee failed to plead sufficient facts to warrant substantive consolidation.[50]

Questioning the Conflict Between Substantive Consolidation and Involuntary Bankruptcy

The *Archdiocese* case is the latest in a series of cases finding that non-debtor substantive consolidation subverts the protections of § 303.[51] This conclusion, however, is by no means universal. Several courts have concluded that the doctrines are distinct and can peacefully coexist in the bankruptcy process.

These courts tend to emphasize that although non-debtor substantive consolidation and involuntary bankruptcy might have similar ends, they serve distinct functions in the bankruptcy process. These courts tend to emphasize that although non-debtor substantive consolidation and involuntary bankruptcy might have similar ends, they serve distinct functions in the bankruptcy process. First, involuntary bankruptcy is a tool that allows creditors to force a failing company to reckon with its distress while there's still something of a company to reckon with.[52] Substantive consolidation, in contrast, aims to untangle the affairs of related entities.[53] Second, as substantive consolidation seeks to increase the assets available to the debtor's creditors, it presumably targets solvent (or less insolvent) non-debtors. Insolvency of the putative debtor is a condition of involuntary bankruptcy.[54] Third, the remedies are exercised by different parties (involuntary bankruptcy by creditors of

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the targeted entity, and substantive consolidation by creditors of the debtor).[55] Other courts have stated that the effect of substantive consolidation is more limited than involuntary bankruptcy, because it merely draws assets into an existing bankruptcy estate, rather than commencing an entirely new bankruptcy case against the non-debtor.[56]

At least in theory, substantive consolidation contains its own protections for the non-debtor and its creditors. The predominant substantive-consolidation tests require some identity of interest between the entities to be consolidated,[57] and each test requires courts to consider the interests and pre-petition expectations of the target's creditors.[58] While these standards are typically weaker than a traditional alter ego showing, most courts have applied non-debtor substantive consolidation restrictively, precisely because of the potential harm on the non-debtor target and its creditors.[59] Indeed, a large number of substantive consolidation cases are accompanied by findings that the parties to be consolidated are alter egos or instrumentalities of the debtor company.[60]

In the context of the Archdiocese case, these distinctions may seem unpersuasive. Yet it is worth observing that the threat of non-debtor substantive consolidation appears strongest, and the overlap with § 303 most pronounced, in precisely this type of case. Where there exists a weak factual predicate for awarding substantive consolidation, the non-debtor seems particularly vulnerable to this equitable remedy.[61] By contrast, the more interrelated the entities to be consolidated, and the greater the abuse of the corporate form, the less pressing the non-debtor's protections in § 303 seem to be. After all, "[a]n entity which is the alter ego of a debtor is not entitled to the safeguards to which a true independent non-debtor would be entitled."[62]

The conflict between substantive consolidation and § 303, then, appears to be driven as much by the facts of a given case as by statutory analysis. While it seems clear that the *Archdiocese* case was rightly decided, it is possible that in appropriate circumstances (such as cases in which the entities are truly alter egos), the doctrines can coexist.

This tentative conclusion does no harm to § 303(a)'s prohibition of involuntary petitions against charitable organizations. This exclusion is thought to protect charitable organizations from "havi[ing] their laudable activities disrupted by liquidation at the instance of pestiferous creditors."[63] Yet there are no bars on non-profit entities voluntarily seeking the protections of bankruptcy, as the Archdiocese did in this case. If the Archdiocese and its non-debtor affiliates lacked any meaningful corporate distinction, § 303(a) would seem inapposite to the decision whether to include the affiliate's assets in the bankruptcy estate.

Of course, the conclusion that non-debtor substantive consolidation does not necessarily conflict with involuntary bankruptcy is not the end of the analysis. Litigants relying on § 105 to achieve non-debtor substantive consolidation must overcome a variety of potential issues with this exercise of the court's equitable authority.[64]

Or do they? An emerging approach grounds non-debtor substantive consolidation not in § 105, but in § 542(a) and the rich history of turnover that began under the Bankruptcy Act of 1898. This approach, which I discuss in the following section, provides an interesting alternative to the traditional substantive consolidation analysis.

An Alternative Approach: Substantive Consolidation as Turnover

Section 542(a) of the Code requires that a person in possession of property of the estate must "deliver to the trustee, and account for, such property or the value of such property,

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unless such property is of inconsequential value or benefit to the estate."[65] The Supreme Court has clarified that "§ 542(a) was simply a codification of turnover powers that had developed under 'judicial precedent predating the Bankruptcy Code,' and '[n]othing in the legislative history evinces a congressional intent to depart from that [pre-Code] practice.' "[66] A closer look at this pre-Code practice reveals a foundation for modern substantive consolidation doctrine.

Under the Bankruptcy Act of 1898, a debtor's bankruptcy estate included not only property in which the debtor had an interest as of the petition date, but also property that the debtor had fraudulently transferred before the petition date.[67] "The express statutory provisions of federal bankruptcy law vesting title to a bankrupt's property in a representative of the bankruptcy estate. . . under the supervision and control of a federal bankruptcy court, have always been considered to give that federal court in rem jurisdiction over that property."[68] As Ralph Brubaker exhaustively traced in an earlier Bankruptcy Law Letter issue, courts developed the turnover procedure as an exercise of this in-rem jurisdiction, in order to draw property of the estate in the possession of a third party back into the custody of the bankruptcy court.[69] Justice Jackson explained the character of the turnover power as such:

> The turnover procedure is one not expressly created or regulated by the Bankruptcy Act. It is a judicial innovation by which the court seeks efficiently and expeditiously to accomplish ends prescribed by the statute, which, however, left the means largely to judicial ingenuity.[70]

Early turnover cases permitted lower courts, in the exercise of their summary jurisdiction, to seize the assets ostensibly owned by a related corporation.[71] The underlying theory for doing so sounded in traditional veil-piercing doctrine, arising from a finding that the related entity was an agency or instrumentality of the debtor.[72] The idea was this: courts were entitled to summarily issue a turnover order against a party who lacked a valid claim of right to the property, because that property was deemed to be in the constructive possession of the trustee.[73] In cases in which the non-debtor was an alter ego or instrumentality of the debtor, the non-debtor lacked a valid claim to the property.[74] Thus, courts permitted turnover of the assets of a related entity on the theory that these assets were rightfully part of the bankrupt's estate.[75]

For example, in *Fish v. East*, the Tenth Circuit upheld a turnover order against a debtor's subsidiary.[76] The court first noted that constructive possession (and thereby jurisdiction for turnover) "may exist where the property is . . . held by one with only a colorable claim."[77] It then held that because the subsidiary was a mere "instrumentality," its claims to possession of the property were "unsubstantial and colorable only."[78]

When necessary, these early cases also addressed the rights of creditors of the seized property in assets returned to the estate.[79] In some cases, like *Fish v. East*, courts gave creditors of the subsidiary first priority in the assets recovered.[80] Others followed an approach akin to modern substantive consolidation, requiring the creditors of all entities to share pari passu.[81]

That was the result in *Sampsell v. Imperial Paper & Color Corp.*, a 1941 Supreme Court Case that courts often cite as the basis for modern substantive consolidation doctrine.[82] In *Sampsell*, the individual debtor had transferred certain assets to a newly formed corporation before filing for bankruptcy relief in an attempt to subvert his creditors.[83] The trustee requested that the corporate property be "marshaled for the benefit of the [individual debtor's] creditors," and the bankruptcy referee ordered what, in substance, amounts to

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turnover.[84] The referee found that the debtor had transferred the property "for the purpose of placing the property beyond the reach of [the debtor's] creditors" and that the corporation was "nothing but a sham and a cloak" devised by the debtor.[85] Accordingly, the referee ordered that "the property of the corporation was property of the bankrupt estate and that it be administered for the benefit of the creditors of the estate . . . ."[86]

A creditor of the corporation filed a claim in the individual's case seeking priority over the corporation's assets.[87] The referee concluded that priority status was improper because the creditor "was instrumental in getting [the debtor] to form the corporation and had full knowledge of its fraudulent character"[88] The referee nevertheless allowed the creditor a general unsecured claim. After the order was confirmed, the Ninth Circuit Court of Appeals reversed.[89] The Supreme Court granted certiorari, and reversed the Circuit Court, holding that the creditor "is entitled only to *pari passu* participation with [the debtor's] individual creditors."[90]

In reaching this holding, the Court used the term "consolidating the estates,"[91] a reference that many courts have cited as the origin of a new doctrine of substantive consolidation. Yet a more careful analysis reflects that *Sampsell* is typical of the turnover cases at the time. Far from creating a new remedy, *Sampsell* reflects a continued emphasis on the federal court's exercise of summary jurisdiction to return property in the hands of alter egos to the bankruptcy estate.[92]

As the Fourth Circuit noted a year after *Sampsell*, for example, "[i]t is manifest, of course, that . . . turnover orders amount to a consolidation of any possible proceedings which might have relation to the affairs of the subsidiary with the bankruptcy proceedings of the parent."[93] The court found it "both logical and convenient" that the turnover, together with any ancillary readjustment of rights, be accomplished in a single proceeding.[94]

Over the next several decades, courts gradually refined and expanded the doctrine of substantive consolidation, a process well documented elsewhere.[95] Nevertheless, up to the enactment of the Bankruptcy Code, "a steady stream of appellate court decisions based upon . . . traditional concepts of property of the estate, summary jurisdiction, and one entity being the alter ego or instrumentality of another continued."[96]

With the enactment of the Bankruptcy Code, the turnover power graduated from "judicial innovation" to a codified power of the bankruptcy courts. In light of this precedent, some courts and commenters have found that § 542 provides an alternative statutory foundation for substantive consolidation of non-debtors.[97]

The most thoughtful case on this topic is *In re Cyberco Holdings, Inc.* This case involved two related technology infrastructure companies that, following the collapse of a fraudulent scheme, entered chapter 7.[98] The trustees sued Huntington Bank, a prepetition lender, to avoid and recover allegedly fraudulent and preferential transfers. Huntington then sought substantive consolidation of the entities, in part because consolidation of the estates would have reduced its potential liability for these transfers.[99] In an exhaustive opinion, the court traced the roots of substantive consolidation, starting with *Sampsell* and its progeny, through modern times.[100] While acknowledging the development of the doctrine, the court traced a common thread—reliance the pre-Code exercise of turnover—throughout.[101] In the end, it concluded that "courts today [should] look to Section 542, not Section 105, as the authoritative source for" substantive consolidation.[102] Although this case involved substantive consolidation of debtors in bankruptcy, its rationale is equally applicable to non-debtor substantive consolidation.

Substantive Consolidation's Relationship to Turnover

Grounding substantive consolidation in the remedy of turnover has intuitive appeal. As Ralph Brubaker is fond of reminding our readers, the bankruptcy laws were enacted against a backdrop of common law.[103] Congress has never purported to codify every right and duty associated with the bankruptcy process, and Bankruptcy Code provisions should be interpreted as displacing only those common law concepts they expressly alter. From this vantage point, the pre-Code practice of seeking turnover of assets held by a related entity under agent, instrumentality, or alter-ego doctrines, now codified in § 542(a), provides a more solid foundation for non-debtor substantive consolidation than general appeals to § 105.

But this alternative foundation does not provide a complete justification for the practice of non-debtor substantive consolidation. In particular, although § 542(a) justifies drawing a target's assets into the bankruptcy case, it does not provide for a resolution of the liabilities of the target entity.[104] Courts confronting this issue might take a variety of approaches. First, harking back to the pre-Code practices, courts might find that addressing the rights of the consolidated entity's creditors was a natural extension of the court's turnover powers.[105] Second, courts could rely on § 105 to fill this interstice. After all, "[e]quity at the very least suggests that some provision should be made for [creditors of an entity targeted for consolidation], especially in those instances when it was the notion that the targeted entity and the bankrupt debtor were one in the same that had prompted the recovery in the first place."[106] Third, courts could follow the approach in *Cyberco*, which seated the power to consolidate liabilities in § 502(j) of the Code.

Section 502(j) provides "[a] claim that has been allowed or disallowed may be reconsidered for cause . . . according to the equities of the case."[107] The *Cyberco* court held "a creditor of an entity successfully targeted . . . may or may not have . . . a claim against the prevailing party. However, if it does not, Section 502(j) would nonetheless permit the creditor a claim if the equities permitted it."[108] The court went on to note that the equities would certainly seem to permit such a claim where "there has been a wholesale seizure by the bankruptcy estate of another entity's assets on the theory that the two were in fact one in the same all along."[109]

Grounding non-debtor substantive consolidation in § 542 also raises procedural issues. For example the turnover power is typically (absent a grant of derivative standing) the unique province of the trustee.[110] As such, creditors' committees and other interested parties might have difficulty asserting substantive consolidation under this alternative framework.[111] In addition, Federal Rule of Bankruptcy Procedure 7001(1) requires a party seeking turnover against a non-debtor to do so in an adversary proceeding,[112] while substantive consolidation is often sought by motion. Yet while these procedural issues might alter the character of the remedy at the margins, the result might have a salutary effect on substantive consolidation's reputation. For example, requiring the doctrine to be exercised through an adversary proceeding might alleviate some of the due-process concerns that have attached to the doctrine's equitable foundations.[113]

Conclusion

Substantive consolidation exists in a "peculiar nether-world," a remedy with trappings of a variety of substantive rights.[114] Its extension to non-debtors raises concerns about circumventing involuntary bankruptcy's protections of the non-debtor, as well as deeper concerns on the scope and limits of the court's equitable

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authority. This issue of the Bankruptcy Law Letter has profiled two alternative foundations for non-debtor substantive consolidation: the traditional approach, which seats the authority to consolidate in § 105, and a new approach that looks at the historical powers of courts to order turnover in the cases of alter ego. A third approach arguably exists. Some courts have looked beyond the doctrine of substantive consolidation altogether, accomplishing the result by applying state veil-piercing doctrine to related entities.[115] As noted above, "[a]n entity which is the alter ego of a debtor is not entitled to the safeguards to which a true independent non-debtor would be entitled."[116] Rather, a successful alter-ego claim results in a finding "the two entitles are not really debtor and non-debtor, but one."[117]

Whatever the proper legal justification for substantive consolidation, it does not appear to have been warranted under the facts of the *Archdiocese* case. While I would be surprised to see this holding disturbed on appeal, I would welcome a ruling from the Eighth Circuit that clarifies the foundation for non-debtor substantive consolidation.

ENDNOTES:

[1]In re Flora Mir Candy Corp., 432 F.2d 1060, 1062 (2d Cir. 1970).

[2]In re Owens Corning, 419 F.3d 195, 205, 45 Bankr. Ct. Dec. (CRR) 36, Bankr. L. Rep. (CCH) P 80343 (3d Cir. 2005), as amended, (Oct. 12, 2005) ("Consolidation restructures (and thus revalues) rights of creditors and for certain creditors this may result in significantly less recovery.").

[3]See Matthew J. Medina, Substantive Consolidation, 2003 Ann. Surv. of Bankr. Law 17 ("Although [non-debtor] substantive consolidation neither harms nor improves the interests of secured creditors, the non-debtor's secured creditors would be forced into bankruptcy litigation to satisfy their claims. The non-debtor's unsecured creditors would have to get in line with the debtor's unsecured creditors for satisfaction of their claims, potentially coming away with nothing.").

[4]In re Lease-A-Fleet, Inc., 141 B.R. 869, 869 (Bankr. E.D. Pa. 1992).

[5]In re Lease-A-Fleet, 141 B.R. at 874.

[6]I refer to this case as the "Archdiocese case."

[7]In re Archdiocese of Saint Paul and Minneapolis, 553 B.R. 693, 704, 62 Bankr. Ct. Dec. (CRR) 269, 75 Collier Bankr. Cas. 2d (MB) 1807 (Bankr. D. Minn. 2016), order aff'd, appeal dismissed, 562 B.R. 755, Bankr. L. Rep. (CCH) P 83044 (D. Minn. 2016), aff'd sub nom. Official Committee of Unsecured Creditors v. Archdiocese of Saint Paul and Minneapolis, 562 B.R. 755, Bankr. L. Rep. (CCH) P 83044 (D. Minn. 2016).

[8]553 B.R. at 700; 562 B.R. at 762 (quoting 11 U.S.C.A. § 303(a)).

[9]The Advisory Committee Note to Federal Rule of Bankruptcy Procedure 1015 provides that "consolidation of the estates of separate debtors may sometimes be appropriate, as when the affairs of an individual and corporation owned or controlled by that individual are so intermingled that the court cannot separate their assets and liabilities." In addition, § 1123(a)(5)(C) of the Code provides that plans may be implemented through "merger or consolidation of the debtor with one or more persons."

[10]Section 105(a) of the Bankruptcy Code permits a court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." 11 U.S.C.A. § 105(a).

[11]See, e.g., In re Augie/Restivo Baking Co., Ltd., 860 F.2d 515, 518, 18 Bankr. Ct. Dec. (CRR) 852, Bankr. L. Rep. (CCH) P 72482 (2d Cir. 1988) (describing substantive consolidation as "a product of judicial gloss").

[12]In re Continental Vending Mach. Corp., 517 F.2d 997, 1000 (2d Cir. 1975).

[13]See, e.g., In re Auto-Train Corp., Inc., 810 F.2d 270, Bankr. L. Rep. (CCH) P 71618 (D.C. Cir. 1987) ("The proponent must show not only a substantial identity between the entities to be consolidated, but also that consolidation is necessary to avoid some harm or to realize some benefit. . . . At this point, a creditor may object on the grounds that it relied on the separate credit of one of the entities and that it will be prejudiced by the consolidation."); In re Augie/Restivo Baking Co., 860 F.2d at 515

(considering (i) "whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit"; or (ii) "whether the affairs of the debtors are so entangled that consolidation will benefit all creditors") (internal quotations omitted); In re Owens Corning, 419 F.3d at 211 (requiring a showing that "i) prepetition [the entities to be consolidated] disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors").

[14]Mary Elisabeth Kors, Altered Egos: Deciphering Substantive Consolidation, 59 U. Pitt. L. Rev. 381, 384 (1998).

[15]Kors, supra note 14, at 397-98 (noting that some courts "use two or more . . . tests simultaneously (and may also quote from the more notable substantive consolidation decisions), often without reconciliation of the cited precedent," and that other courts "have approved or denied substantive consolidation without analyzing any precedent or without relying on any expressed standard.").

[16]See Kors, supra note 14, at 397 ("The command 'Look at the facts and do equity' may provide as much guidance as the frequently confusing and inconsistent tests in modern substantive consolidation cases.").

[17]See, e.g., Douglas G. Baird, Substantive Consolidation Today, 47 B.C. L. Rev. 5, 15 (2005) (noting substantive consolidation is "firmly embedded in day-to-day practice"); Eastgroup Properties v. Southern Motel Ass'n, Ltd., 935 F.2d 245, 248, 21 Bankr. Ct. Dec. (CRR) 1423, 25 Collier Bankr. Cas. 2d (MB) 158, Bankr. L. Rep. (CCH) P 74055 (11th Cir. 1991) (noting a trend toward greater court approval of the doctrine, based on "increased judicial recognition of the widespread use of interrelated corporate structures").

[18]The following cases permitted non-debtor substantive consolidation: In re Bonham, 229 F.3d 750, 765 (9th Cir. 2000); In re Alico Mining, Inc., 278 B.R. 586 (Bankr. M.D. Fla. 2002); In re United Stairs Corp., 176 B.R. 359, 32 Collier Bankr. Cas. 2d (MB) 1908 (Bankr. D. N.J. 1995); Matter of New Center Hosp., 179 B.R. 848, 32 Collier Bankr. Cas. 2d (MB) 1696, 74 A.F.T.R.2d 94-5656 (Bankr. E.D. Mich. 1994), decision aff'd in part, rev'd on other grounds in part, 187 B.R. 560, 76 A.F.T.R.2d 95-6171 (E.D. Mich. 1995); Matter of Munford, Inc., 115 B.R. 390, 20 Bankr. Ct. Dec. (CRR) 1066, 23 Collier Bankr. Cas. 2d (MB) 60 (Bankr. N.D. Ga. 1990); In re Tureaud, 59 B.R. 973, 14 Collier Bankr. Cas. 2d (MB) 1131 (N.D. Okla. 1986); In re Crabtree, 39 B.R. 718, 11 Bankr. Ct. Dec. (CRR) 1075 (Bankr. E.D. Tenn. 1984); In re 1438 Meridian Place, N. W., Inc., 15 B.R. 89, 8 Bankr. Ct. Dec. (CRR) 463, Bankr. L. Rep. (CCH) P 68620 (Bankr. D. D.C. 1981); Soviero v. Franklin Nat. Bank of Long Island, 328 F.2d 446 (2d Cir. 1964).

[19]See, e.g.,Matter of New Center Hosp., 187 B.R. 560, 568, 76 A.F.T.R.2d 95-6171 (E.D. Mich. 1995) ("[D]etermination of whether [entities] are alter egos of one another is critical" to finding non-debtor substantive consolidation); In re Horsley, 47 Collier Bankr. Cas. 2d (MB) 103, 2001 WL 1682013 (Bankr. D. Utah 2001) ("Certainly, for substantive consolidation to effectively bring a nondebtor within the jurisdiction of this court, the identity of the nondebtor must be so far subsumed in the debtor that they are as one."); Scott L. Swanson, The Case for Nondebtor Substantive Consolidation under the Turnover Power of Section 542(a), 22 J. Bankr. L. & Prac. 3 Art. 4 (May 2013) at n.37 (collecting cases finding "alter-ego status critical to the substantive consolidation inquiry"); see also Bruce H. White & William L. Medford, Substantive Consolidation of Non-Debtor Entities: Tag, You're in Bankruptcy, Am. Bankr. Inst. J., December/January 2004, at 46 ("[T]he particular facts must present an element of fraud, injustice or fundamental unfairness, and it is only under such limited circumstances that substantive consolidation of a non-debtor is appropriate.").

[20]See, e.g., In re Pearlman, 462 B.R. 849, 55 Bankr. Ct. Dec. (CRR) 275, 66 Collier Bankr. Cas. 2d (MB) 1522, Bankr. L. Rep. (CCH) P 82157 (Bankr. M.D. Fla. 2012); In re Circle Land and Cattle Corp., 213 B.R. 870, 877, 31 Bankr. Ct. Dec. (CRR) 751, 38 Collier Bankr. Cas. 2d (MB) 1749 (Bankr. D. Kan. 1997); In re Julien Co., 120 B.R. 930, 21 Bankr. Ct. Dec. (CRR) 58 (Bankr. W.D. Tenn. 1990); In re R.H.N. Realty Corp., 84 B.R. 356 (Bankr. S.D. N.Y. 1988); In re DRW Property Co. 82, 54 B.R. 489 (Bankr. N.D. Tex. 1985); In re Alpha & Omega Realty, Inc., 36 B.R. 416, 11 Bankr. Ct. Dec. (CRR) 689 (Bankr. D. Idaho 1984).

[21]See, e.g., Circle Land & Cattle Corp., 213 B.R. at 877.

[22]See, e.g., In re Julien Co., 120 B.R. at 937.

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[23]See, e.g., In re Lease-A-Fleet, Inc., 141 B.R. at 869.

[24]Some commenters have questioned the continued viability of substantive consolidation in the wake of Grupo Mexicano de Desarrollo S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308, 333, 119 S. Ct. 1961, 144 L. Ed. 2d 319, Bankr. L. Rep. (CCH) P 77943, 1999 A.M.C. 1963 (1999), a theory that courts, so far, have declined to embrace.

[25]In re Lease-A-Fleet, Inc., 141 B.R. at 873.

[26]See generally 11 U.S.C.A. § 303.

[27]Petitioners are typically liable for the costs and reasonable attorneys' fees incurred defending the petition. Further damages, including punitive damages, may be awarded if the filing is found to have been made in "bad faith." 11 U.S.C.A. § 303(i)(2).

[28]11 U.S.C.A. § 303(a).

[29]S. Rep. No. 95-989, at 32 (1978) as reprinted in 1978 U.S.C.C.A.N. 5787, 5818.

[30]For another case presenting a similar potential conflict, see In re Circle Land & Cattle Corp., 213 B.R at 876 (refusing to permit substantive consolidation of a non-debtor farmer and noting, in dicta, that the farmer was exempted from involuntary bankruptcy).

[31]In re Archdiocese of Saint Paul and Minneapolis, 553 B.R. at 696.

[32]For a thorough discussion of archdiocese bankruptcy cases and the complicated Constitutional and doctrinal issues that arise, see Jonathan C. Lipson, When Churches Fail: The Diocesan Debtor Dilemmas, 79 S. Cal. L. Rev. 363 (2006).

[33]The plan has subsequently been amended to include over $133 million in assets.

[34]To add intrigue, a private individual submitted a letter to the bankruptcy court claiming that the Archdiocese had delivered several shoeboxes worth of ancient jewels and art to a local jeweler in the mid-1990s, which apparently were not disclosed in the bankruptcy case. Letter filed by Thomas S. De Lyser at 1, In re the Archdiocese of Saint Paul and Minneapolis, No. 15-30125 (Bankr. D. Minn. June 8, 2016).

[35]Certain personal injury creditors also joined the motion. In re Archdiocese of Saint Paul and Minneapolis, 553 B.R. at 697.

[36]In re Archdiocese of Saint Paul and Minneapolis, 553 B.R. at 702.

[37]Motion filed by Official Comm. of Unsec. Creds Seeking Substantive Consolidation of the Debtor's Estate with its Parishes and Certain Other Non-Debtor Entities: Memorandum of Law at 43, In re the Archdiocese of Saint Paul and Minneapolis, No. 15-30125 (Bankr. D. Minn. May 23, 2016).

[38]The bankruptcy court had ordered the parties to apply Rule 7012 to the motion. Accordingly, the response took the form of motions for judgment on the pleadings and motions to dismiss. 553 B.R. at 697.

[39]In re Archdiocese of St. Paul & Minneapolis, 553 B.R. at 704.

[40]Law v. Siegel, 134 S. Ct. 1188, 1194, 188 L. Ed. 2d 146, 59 Bankr. Ct. Dec. (CRR) 43, Bankr. L. Rep. (CCH) P 82592 (2014).

[41]In re Archdiocese of Saint Paul and Minneapolis, 553 B.R. at 700.

[42]In re Archdiocese of Saint Paul and Minneapolis, 553 B.R. at 700-01.

[43]In re Giller, 962 F.2d 796, 799, 22 Bankr. Ct. Dec. (CRR) 1505, Bankr. L. Rep. (CCH) P 74547 (8th Cir. 1992).

[44]In re Archdiocese of Saint Paul and Minneapolis, 553 B.R. at 703 ("There is no doubt that the Catholic Church is hierarchical in its organization and authoritarian in doctrinal matters. But those characteristics are insufficient for a court to ignore its corporate legal structure").

[45]In re Archdiocese of Saint Paul and Minneapolis, 553 B.R. at 703 (finding the facts alleged "implausible . . . and internally inconsistent").

[46]In re Archdiocese of Saint Paul and Minneapolis, 553 B.R. at 704 (allegations of prejudice based on the channeling injunction contained in the plan are best reserved for plan confirmation).

[47]In re Archdiocese of Saint Paul and Minneapolis, 553 B.R. at 704.

[48]Archdiocese of Saint Paul and Minneapolis, 562 B.R. at 759.

[49]Archdiocese of Saint Paul and Minneapolis, 562 B.R. at 762-63.

[50]Archdiocese of Saint Paul and Minneapolis, 562 B.R. at 763.

[51]For earlier cases reaching this holding, see supra note 20.

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[52]For a thoughtful discussion of the rationale behind involuntary bankruptcy, see Adam Feibelman, Involuntary Bankruptcy for American States, Duke J. Const. L. & Pub. Pol. 81, 83-89 (2012).

[53]Kors, supra note 14, at 384.

[54]In re S & G Fin. Servs. of S. Florida, Inc., 451 B.R. at 582.

[55]In re 1438 Meridian Place N.W., Inc., 15 B.R. at 95.

[56]See, e.g., In re Munford, Inc., 115 B.R. at 397. The substantive consolidation case law reflects deep uncertainty about what substantive consolidation actually accomplishes, an issue that arose in another case before Judge Kressel this year. In re Petters Company, Inc., 550 B.R. 438, 62 Bankr. Ct. Dec. (CRR) 180 (Bankr. D. Minn. 2016) (considering whether substantive consolidation transferred predicate creditor standing for avoidance actions).

[57]See, e.g., In re Auto-Train Corp., Inc., 810 F.2d at 276 (requiring a "substantial identity" between the parties); In re Augie/Restivo Baking Co., 860 F.2d at 518 (requiring that the creditors must have dealt with the debtors as a single economic unit); In re Owens Corning, 419 F.3d at 211 (requiring a disregard to the extent that creditors treated the entities as one legal entity); In re Giller, 962 F.2d at 799 (considering the necessity of consolidation because of a relationship between the debtors). See also Kors, supra note 14, at 399-402 (describing the various tests and their emphasis on traditional alter-ego principles).

[58]See, e.g., In re Auto-Train Corp., Inc., 810 F.2d at 276 (creditors may prevent consolidation by demonstrating reliance on separate credit of one of the entities and prejudice); In re Augie/Restivo Baking Co., 860 F.2d at 518 (requiring either that creditors did not rely on the separate identity of the consolidated entities in extending credit; or that the debtors' affairs were so entangled that "consolidation would benefit all creditors"); Owens Corning, 419 F.3d at 211 (requiring either that creditors have relied on the breakdown of borders and treated the entities as one or have assets and liabilities that were so intermingled post petition that separating them is prohibitive and harmful to all creditors); In re Giller, 962 F.2d 796, 799, 22 Bankr. Ct. Dec. (CRR) 1505, Bankr. L. Rep. (CCH) P 74547 (8th Cir. 1992) (balancing the benefits of consolidation against the harm to creditors); see also Kors, supra note 14, at 402-407 (discussing courts' balancing).

[59]See supra n. 18.

[60]See e.g., In re Bonham, 229 F.3d at 766-67 (finding, in a case involving a Ponzi scheme, that the various entities to be consolidated were "but instrumentalities of the bankrupt with no separate existence of their own"); In re Alico Mining, Inc., 278 B.R. at 588 (concluding non-debtor substantive consolidation may only be achieved "by destroying the independent legal existence of the nondebtor entity by removing its corporate shield"); In re United Stairs Corp., 176 B.R. at 369 (Bankr. D.N.J. 1995) (concluding that in cases in which the entities are alter-egos, non-debtor substantive consolidation is available); In re Crabtree, 39 B.R. at 722 (concluding alter-egos could be added to a bankruptcy petition without following the procedures for involuntary bankruptcy); In re 1438 Meridian Place, N.W., Inc., 15 B.R. at 95 (same); but see In re Creditors Serv. Corp., 195 B.R. at 690 (not relying expressly on an alter-ego showing, but permitting non-debtor substantive consolidation when the entities were so entangled that they constitute a single enterprise and where the debtor had concealed assets from creditors); In re Munford, Inc., 115 B.R. at 394 (distinguishing substantive consolidation from "instrumentality" theory).

[61]Baird, supra note 17, at 21 ("The more the power of substantive consolidation departs from traditional veil-piercing, the harder it is to locate the power inside the Bankruptcy Code").

[62]In re United Stairs Corp., 176 B.R. 359, 370, 32 Collier Bankr. Cas. 2d (MB) 1908 (Bankr. D. N.J. 1995).

[63]See Michael I. Sovern, Section 4 of the Bankruptcy Act: The Excluded Corporations, 42 Minn. L. Rev. 171. 232 (1957).

[64]See supra notes 20-24.

[65]11 U.S.C.A. § 542(a).

[66]Ralph Brubaker, Turnover, Adequate Protection, and the Automatic Stay (Part I):

Origins and Evolution of the Turnover Power, 33 Bankr. L. Letter No. 8, at 2 (August 2013) (quoting U.S. v. Whiting Pools, Inc., 1983-2 C.B. 239, 462 U.S. 198, 208, 103 S. Ct. 2309, 76 L. Ed. 2d 515, 10 Bankr. Ct. Dec. (CRR) 705, 8 Collier Bankr. Cas. 2d (MB) 710, Bankr. L. Rep. (CCH) P 69207, 83-1 U.S. Tax Cas. (CCH) P 9394, 52 A.F.T.R.2d 83-5121 (1983)).

[67]See Maggio v. Zeitz, 333 U.S. 56, 62, 68 S.

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Ct. 401, 92 L. Ed. 476 (1948) (citing 11 U.S.C.A. § 110 (repealed) ("The Act vests title to all property of the bankrupt, including any transferred in fraud of creditors, in the trustee, as of the date of filing the petition in bankruptcy.").

[68]Brubaker, supra note 66, at 1, 3.

[69]Brubaker, supra note 66, at 3 (explaining the origins of turnover as "an incident to a bankruptcy court's in rem jurisdiction over a debtor's bankruptcy estate.").

[70]Brubaker, supra note 66, at 3 (quoting Maggio, 333 U.S. at 61).

[71]See, e.g., Central Republic Bank & Trust Co. v. Caldwell, 58 F.2d 721, 735 (C.C.A. 8th Cir. 1932) (affirming turnover order against non-debtor subsidiary, because the subsidiary was "an agency and instrumentality of the [bankrupt utility]."); see also In re Cyberco Holdings, Inc., 431 B.R. 404, 414-15, 53 Bankr. Ct. Dec. (CRR) 98 (Bankr. W.D. Mich. 2010).

[72]See Cyberco, 431 B.R. at 414-15 (collecting cases).

[73]Brubaker, supra note 66, at 3 ("Traditionally, such property has been considered within the 'constructive' possession of a federal bankruptcy court only to the extent the third party raises no substantial defenses to turnover of the property.") (quotation omitted).

[74]Fish v. East, 114 F.2d 177 (C.C.A. 10th Cir. 1940) (upholding the turnover of assets of a subsidiary based on a finding that the subsidiary was an "instrumentality" of the parent company).

[75]See, e.g., In re Eilers Music House, 270 F. 915, 924 (C.C.A. 9th Cir. 1921), aff'd, 274 F. 330 (C.C.A. 9th Cir. 1921) (Ordering turnover of assets of subsidiary, which had no separate existence from the parent, in a summary proceeding).

[76]Fish, 114 F.2d at 189.

[77]Fish, 114 F.2d at 189.

[78]Fish, 114 F.2d at 189.

[79]See Kors, supra note 14, at 391 (noting in many early cases, "turnover did not provoke a conflict between parent and subsidiary creditors because the subsidiary did not have creditors.").

[80]See Kors, supra note 14, at 391 & n.49 (collecting cases).

[81]See, e.g., Stone v. Eacho, 127 F.2d 284, 287 (C.C.A. 4th Cir. 1942) (finding "no good reason why the creditors dealing with [non-debtor subsidiary] should be dealt with differently from . . . other creditors").

[82]313 U.S. 215 (1941).

[83]313 U.S. at 216-17.

[84]313 U.S. at 217.

[85]313 U.S. at 217.

[86]313 U.S. at 217.

[87]313 U.S. at 217.

[88]313 U.S. at 217.

[89]313 U.S. at 217.

[90]313 U.S. at 221.

[91]313 U.S. at 219.

[92]See J. Maxwell Tucker, Substantive Consolidation: The Cacophony Continues, 18 Am. Bankr. Inst. L. Rev. 89, 110-11 (2010) ("The notion that three years after Erie the Supreme Court invented a new federal substantive law out of whole cloth, eventually to be called substantive consolidation, suggests that the Justices were suffering from amnesia. . . . The more plausible view is that the Justices did not change course, but merely construed the scope of the bankruptcy court's summary jurisdiction.").

[93]Stone, 127 F.2d at 289.

[94] Stone, 127 F.2d at 289.

[95]See, e.g., Cyberco, 431 B.R. at 410-25; Kors, supra note 14.

[96]Cyberco, 431 B.R. at 417-18; see also Baird, supra note 17, at 16.

[97]See, e.g. Cyberco, 431 B.R. at 430-31; Munford, 115 B.R. at 398 (likening consolidation to "a complex turnover proceeding"); see also *Swanson*, supra note 19.

[98]Cyberco, 431 B.R. at 406. (Following receivership, the creditors of one entity commenced an involuntary chapter 7 bankruptcy. The receiver did not oppose the petition, and filed a voluntary petition on behalf of the related entity).

[99]Cyberco, 431 B.R. at 407.

[100]Cyberco, 431 B.R. at 410-25.

[101]In particular, the court rejected a characterization that historical notions of substantive consolidation have been replaced by a "liberal" trend of cases. Cyberco, 431 B.R. at 417-18.

[102]Cyberco, 431 B.R. at 422.

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[103]See, e.g., Ralph Brubaker, Preferential Payment of a Nondischargeable Debt and the Dischargeability of the Creditor's § 502(h) Claim Upon Recovery Thereof: Considering the Common Law Origins and Nature of the Code's Avoidance Remedy, 27 Bankr. L. Letter No. 1, at 5-7 (Jan. 2007); Ralph Brubaker, Lien Avoidance "for the Benefit of the Estate": Textualism, Equitable Powers, and Code Common Law, 26 Bankr. L. Letter No. 1, at 5-8 (Jan. 2006); Ralph Brubaker, Operating in the Involuntary Gap: What To Do Regarding Payments to a Secured Creditor?, 24 Bankr. L. Letter No. 9, at 7-8 (Sept. 2004); Ralph Brubaker, Creditor/Committee Derivative Litigation: Of Textualism and Equitable Powers, 22 Bankr. L. Letter No. 11, at 1-8 (Nov. 2002); Ralph Brubaker, Subrogation, Letters of Credit, and Discharge Exceptions, 22 Bankr. L. Letter No. 9, at 1-8 (Sept. 2002).

[104]See Swanson, supra note 19.

[105]See Stone, 127 F.2d at 289.

[106]Cyberco, 431 B.R. at 422.

[107]11 U.S.C.A. § 502(j).

[108]Cyberco, 431 B.R. at 423.

[109]Cyberco, 431 B.R. at 423.

[110]See, e.g., In re Cooper, 405 B.R. 801, 51 Bankr. Ct. Dec. (CRR) 207 (Bankr. N.D. Tex. 2009); but see In re Valley Media, Inc., 2003 WL 21956410 (Bankr. D. Del. 2003) (granting creditors' committee derivative standing).

[111]See Cyberco, 431 B.R. at 431.

[112]See, e.g., In re Toledano, 299 B.R. 284 (Bankr. S.D. N.Y. 2003).

[113]See supra note 57.

[114]Baird, supra note 17, at 21.

[115]See, e.g., In re Duckworth, 2012 WL 4434681, *6 (Bankr. C.D. Ill. 2012) (describing veil-piercing in the bankruptcy context as a "less cumbersome alternative" for drawing an alter ego's assets into the estate).

[116]In re United Stairs Corp., 176 B.R. at 369-70.

[117]In re Pearlman, 462 B.R. at 855.

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Judges' Roundtable
Saturday March 17, 2018

The SCOTUS Decision in *US Bank v. Village at Lakeridge*

Hon. Mary Grace Diehl
United States Bankruptcy Judge
Northern District of Georgia

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Timber & Lumber Co.,* 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

U. S. BANK N. A., TRUSTEE, BY AND THROUGH CWCAPITAL ASSET MANAGEMENT LLC *v.* VILLAGE AT LAKERIDGE, LLC

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 15–1509. Argued October 31, 2017—Decided March 5, 2018

Respondent Lakeridge is a corporate entity with a single owner, MBP Equity Partners. When Lakeridge filed for Chapter 11 bankruptcy, it had a pair of substantial debts: It owed petitioner U. S. Bank over $10 million and MBP another $2.76 million. Lakeridge submitted a reorganization plan, proposing to impair the interests of both U. S. Bank and MBP. U. S. Bank refused the offer, thus blocking Lakeridge's option for reorganization through a fully consensual plan. See 11 U. S. C. §1129(a)(8). Lakeridge then turned to the so-called "cramdown" plan option for imposing a plan impairing the interests of a non-consenting class of creditors. See §1129(b). Among the prerequisites for judicial approval of such a plan is that another impaired class of creditors has consented to it. See §1129(a)(10). But crucially here, the consent of a creditor who is also an "insider" of the debtor does not count for that purpose. *Ibid.* The Bankruptcy Code's definition of an insider "includes" any director, officer, or "person in control" of the entity. §101(31)(B)(i)–(iii). Courts have devised tests for identifying other, so-called "non-statutory" insiders, focusing, in whole or in part, on whether a person's transactions with the debtor were at arm's length.

Here, MBP (an insider of Lakeridge) could not provide the partial agreement needed for a cramdown plan, and Lakeridge's reorganization was thus impeded. MBP sought to transfer its claim against Lakeridge to a non-insider who could agree to the cramdown plan. Kathleen Bartlett, an MBP board member and Lakeridge officer, offered MBP's claim to Robert Rabkin, a retired surgeon, for $5,000. Rabkin purchased the claim and consented to Lakeridge's proposed

reorganization. U. S. Bank objected, arguing that Rabkin was a non-statutory insider because he had a "romantic" relationship with Bartlett and the purchase was not an arm's-length transaction. The Bankruptcy Court rejected U. S. Bank's argument. The Ninth Circuit affirmed. Viewing the Bankruptcy Court's decision as one based on a finding that the relevant transaction was conducted at arm's length, the Ninth Circuit held that that finding was entitled to clear-error review, and could not be reversed under that deferential standard.

Held: The Ninth Circuit was right to review the Bankruptcy Court's determination for clear error (rather than *de novo*). At the heart of this case is a so-called "mixed question" of law and fact—whether the Bankruptcy Court's findings of fact satisfy the legal test chosen for conferring non-statutory insider status. U. S. Bank contends that the Bankruptcy Court's resolution of this mixed question must be reviewed *de novo*, while Lakeridge (joined by the Federal Government) argues for a clear-error standard.

For all their differences, both parties rightly point to the same query: What is the nature of the mixed question here and which kind of court (bankruptcy or appellate) is better suited to resolve it? Mixed questions are not all alike. Some require courts to expound on the law, and should typically be reviewed *de novo*. Others immerse courts in case-specific factual issues, and should usually be reviewed with deference. In short, the standard of review for a mixed question depends on whether answering it entails primarily legal or factual work.

Here, the Bankruptcy Court confronted the question whether the basic facts it had discovered (concerning Rabkin's relationships, motivations, etc.) were sufficient to make Rabkin a non-statutory insider. Using the transactional prong of the Ninth Circuit's legal test for identifying such insiders (whether the transaction was conducted at arm's length, *i.e.,* as though the two parties were strangers) the mixed question became: Given all the basic facts found, was Rabkin's purchase of MBP's claim conducted as if the two were strangers to each other? That is about as factual sounding as any mixed question gets. Such an inquiry primarily belongs in the court that has presided over the presentation of evidence, that has heard all the witnesses, and that has both the closest and deepest understanding of the record—*i.e.*, the bankruptcy court. One can arrive at the same point by asking how much legal work applying the arm's-length test requires. It is precious little—as shown by judicial opinions applying the familiar legal term without further elaboration. Appellate review of the arm's-length issue—even if conducted *de novo*—will not much clarify legal principles or provide guidance to other courts resolving

other disputes. The issue is therefore one that primarily rests with a bankruptcy court, subject only to review for clear error. Pp. 5–11.

814 F. 3d 993, affirmed.

KAGAN, J., delivered the opinion for a unanimous Court. KENNEDY, J., filed a concurring opinion. SOTOMAYOR, J., filed a concurring opinion, in which KENNEDY, THOMAS, and GORSUCH, JJ., joined.

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D. C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 15–1509

U.S. BANK NATIONAL ASSOCIATION, TRUSTEE, BY AND THROUGH CWCAPITAL ASSET MANAGEMENT LLC, PETITIONER *v.* THE VILLAGE AT LAKERIDGE, LLC

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

[March 5, 2018]

JUSTICE KAGAN delivered the opinion of the Court.

The Bankruptcy Code places various restrictions on anyone who qualifies as an "insider" of a debtor. The statutory definition of that term lists a set of persons related to the debtor in particular ways. See 11 U. S. C. §101(31). Courts have additionally recognized as insiders some persons not on that list—commonly known as "non-statutory insiders." The conferral of that status often turns on whether the person's transactions with the debtor (or another of its insiders) were at arm's length. In this case, we address how an appellate court should review that kind of determination: *de novo* or for clear error? We hold that a clear-error standard should apply.

I

Chapter 11 of the Bankruptcy Code enables a debtor company to reorganize its business under a court-approved plan governing the distribution of assets to creditors. See 11 U. S. C. §1101 *et seq.* The plan divides claims against the debtor into discrete "classes" and speci-

fies the "treatment" each class will receive. §1123; see §1122. Usually, a bankruptcy court may approve such a plan only if every affected class of creditors agrees to its terms. See §1129(a)(8). But in certain circumstances, the court may confirm what is known as a "cramdown" plan—that is, a plan impairing the interests of some non-consenting class. See §1129(b). Among the prerequisites for judicial approval of a cramdown plan is that another impaired class of creditors has consented to it. See §1129(a)(10). But crucially for this case, the consent of a creditor who is also an "insider" of the debtor does not count for that purpose. See *ibid.* (requiring "at least one" impaired class to have "accepted the plan, determined without including any acceptance of the plan by any insider").

The Code enumerates certain insiders, but courts have added to that number. According to the Code's definitional section, an insider of a corporate debtor "includes" any director, officer, or "person in control" of the entity. §§101(31)(B)(i)–(iii). Because of the word "includes" in that section, courts have long viewed its list of insiders as non-exhaustive. See §102(3) (stating as one of the Code's "[r]ules of construction" that "'includes' and 'including' are not limiting"); 2 A. Resnick & H. Sommer, Collier on Bankruptcy ¶101.31, p. 101–142 (16th ed. 2016) (discussing cases). Accordingly, courts have devised tests for identifying other, so-called "non-statutory" insiders. The decisions are not entirely uniform, but many focus, in whole or in part, on whether a person's "transaction of business with the debtor is not at arm's length." *Ibid.* (quoting *In re U. S. Medical, Inc.*, 531 F. 3d 1272, 1280 (CA10 2008)).

This case came about because the Code's list of insiders placed an obstacle in the way of respondent Lakeridge's attempt to reorganize under Chapter 11. Lakeridge is a corporate entity which, at all relevant times, had a single

owner, MBP Equity Partners, and a pair of substantial debts. The company owed petitioner U. S. Bank over $10 million for the balance due on a loan. And it owed MBP another $2.76 million. In 2011, Lakeridge filed for Chapter 11 bankruptcy. The reorganization plan it submitted placed its two creditors in separate classes and proposed to impair both of their interests. U. S. Bank refused that offer, thus taking a fully consensual plan off the table. But likewise, a cramdown plan based only on MBP's consent could not go forward. Recall that an insider cannot provide the partial agreement needed for a cramdown plan. See *supra,* at 2; §1129(a)(10). And MBP was the consummate insider: It owned Lakeridge and so was—according to the Code's definition—"in control" of the debtor. §101(31)(B)(iii). The path to a successful reorganization was thus impeded, and Lakeridge was faced with liquidation. Unless . . .

Unless MBP could transfer its claim against Lakeridge to a non-insider who would then agree to the reorganization plan. So that was what MBP attempted. Kathleen Bartlett, a member of MBP's board and an officer of Lakeridge, approached Robert Rabkin, a retired surgeon, and offered to sell him MBP's $2.76 million claim for $5,000. Rabkin took the deal. And as the new holder of MBP's old loan, he consented to Lakeridge's proposed reorganization. As long as he was not himself an insider, Rabkin's agreement would satisfy one of the prerequisites for a cramdown plan. See §1129(a)(10); *supra,* at 2. That would bring Lakeridge a large step closer to reorganizing its business over U. S. Bank's objection.

Hence commenced this litigation about whether Rabkin, too, was an insider. U. S. Bank argued that he qualified as a non-statutory insider because he had a "romantic" relationship with Bartlett and his purchase of MBP's loan "was not an arm's-length transaction." Motion to Designate Claim of Robert Rabkin as an Insider Claim in No.

11–51994 (Bkrtcy. Ct. Nev.), Doc. 194, p. 11 (Motion).[1] At an evidentiary hearing, both Rabkin and Bartlett testified that their relationship was indeed "romantic." App. 128, 142–143.[2] But the Bankruptcy Court still rejected U. S. Bank's view that Rabkin was a non-statutory insider. See App. to Pet. for Cert. 66a. The court found that Rabkin purchased the MBP claim as a "speculative investment" for which he did adequate due diligence. *Id.*, at 67a. And it noted that Rabkin and Bartlett, for all their dating, lived in separate homes and managed their finances independently. See *id.,* at 66a.

The Court of Appeals for the Ninth Circuit affirmed by a divided vote. According to the court, a creditor qualifies as a non-statutory insider if two conditions are met: "(1) the closeness of its relationship with the debtor is comparable to that of the enumerated insider classifications in [the Code], and (2) the relevant transaction is negotiated at less than arm's length." *In re Village at Lakeridge, LLC,* 814 F. 3d 993, 1001 (2016). The majority viewed the Bankruptcy Court's decision as based on a finding that the relevant transaction here (Rabkin's purchase of MBP's claim) "was conducted at arm's length." *Id.,* at 1003, n. 15. That finding, the majority held, was entitled to clear-error review, and could not be reversed under that deferential

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[1] U. S. Bank also contended that Rabkin automatically inherited MBP's statutory insider status when he purchased its loan. See Motion, p. 10 ("[A]n entity which acquires a claim steps into the shoes of that claimant" (internal quotation marks omitted)). We did not grant review of that question and therefore do not address it in this opinion.

[2] Perhaps Bartlett expressed some ambivalence on that score. The transcript of her direct examination reads:

"Q. Okay. And I think the term has been a romantic relationship—you have a romantic relationship?

A. I guess.

Q. Why do you say I guess?

A. Well, no—yes." App. 142–143.

One hopes Rabkin was not listening.

standard. See *id.,* at 1001–1003. Rabkin's consent could therefore support the cramdown plan. See *id.,* at 1003. Judge Clifton dissented. He would have applied *de novo* review, but in any event thought the Bankruptcy Court committed clear error in declining to classify Rabkin as an insider. See *id.,* at 1006.

This Court granted certiorari to decide a single question: Whether the Ninth Circuit was right to review for clear error (rather than *de novo*) the Bankruptcy Court's determination that Rabkin does not qualify as a non-statutory insider because he purchased MBP's claim in an arm's-length transaction. 580 U. S. ___ (2017).

II

To decide whether a particular creditor is a non-statutory insider, a bankruptcy judge must tackle three kinds of issues—the first purely legal, the next purely factual, the last a combination of the other two. And to assess the judge's decision, an appellate court must consider all its component parts, each under the appropriate standard of review. In this case, only the standard for the final, mixed question is contested. But to resolve that dispute, we begin by describing the unalloyed legal and factual questions that both kinds of courts have to address along the way, as well as the answers that the courts below provided.

Initially, a bankruptcy court must settle on a legal test to determine whether someone is a non-statutory insider (again, a person who should be treated as an insider even though he is not listed in the Bankruptcy Code). But that choice of standard really resides with the next court: As all parties agree, an appellate panel reviews such a legal conclusion without the slightest deference. See *Highmark Inc.* v. *Allcare Health Management. System, Inc.*, 572 U. S. ___, ___ (2014) (slip op., at 4) ("Traditionally, decisions on questions of law are reviewable *de novo*" (internal quota-

tion marks omitted)); Tr. of Oral Arg. 29–30, 33. The Ninth Circuit here, as noted earlier, endorsed a two-part test for non-statutory insider status, asking whether the person's relationship with the debtor was similar to those of listed insiders and whether the relevant prior transaction was at "less than arm's length." 814 F. 3d, at 1001; see *supra,* at 4–5. And the Ninth Circuit held that the Bankruptcy Court had used just that standard—more specifically, that it had denied insider status under the test's second, transactional prong. See 814 F. 3d, at 1002–1003, and n. 15; *supra,* at 4–5. We do not address the correctness of the Ninth Circuit's legal test; indeed, we specifically rejected U. S. Bank's request to include that question in our grant of certiorari. See 580 U. S. ___; Pet. for Cert. i. We simply take that test as a given in deciding the standard-of-review issue we chose to resolve.

Along with adopting a legal standard, a bankruptcy court evaluating insider status must make findings of what we have called "basic" or "historical" fact—addressing questions of who did what, when or where, how or why. *Thompson* v. *Keohane*, 516 U. S. 99, 111 (1995). The set of relevant historical facts will of course depend on the legal test used: So under the Ninth Circuit's test, the facts found may relate to the attributes of a particular relationship or the circumstances and terms of a prior transaction. By well-settled rule, such factual findings are reviewable only for clear error—in other words, with a serious thumb on the scale for the bankruptcy court. See Fed. Rule Civ. Proc. 52(a)(6) (clear-error standard); Fed. Rules Bkrtcy. Proc. 7052 and 9014(c) (applying Rule 52 to various bankruptcy proceedings). Accordingly, as all parties again agree, the Ninth Circuit was right to review deferentially the Bankruptcy Court's findings about Rabkin's relationship with Bartlett (*e.g.,* that they did not "cohabitate" or pay each other's "bills or living expenses") and his motives for purchasing MBP's claim (*e.g.,* to make

a "speculative investment"). App. to Pet. for Cert. 66a–67a; see Tr. of Oral Arg. 8, 39.

What remains for a bankruptcy court, after all that, is to determine whether the historical facts found satisfy the legal test chosen for conferring non-statutory insider status. We here arrive at the so-called "mixed question" of law and fact at the heart of this case. *Pullman-Standard* v. *Swint*, 456 U. S. 273, 289, n. 19 (1982) (A mixed question asks whether "the historical facts . . . satisfy the statutory standard, or to put it another way, whether the rule of law as applied to the established facts is or is not violated"). As already described, the Bankruptcy Court below had found a set of basic facts about Rabkin; and it had adopted a legal test for non-statutory insider status that requires (as one of its two prongs) a less-than-arm's-length transaction. See *supra,* at 4, 6. As its last move, the court compared the one to the other—and determined that the facts found did not show the kind of preferential transaction necessary to turn a creditor into a non-statutory insider. For that decisive determination, what standard of review should apply?

The parties, after traveling so far together, part ways at this crucial point. U. S. Bank contends that the Bankruptcy Court's resolution of the mixed question must be reviewed *de novo*. That is because, U. S. Bank claims, application of the Ninth Circuit's "very general" standard to a set of basic facts requires the further elaboration of legal principles—a task primarily for appellate courts. Brief for Petitioner 35; see *id.,* at 53 (The "open-ended nature of the Ninth Circuit's standard" compels courts to "develop the norms and criteria they deem most appropriate" and so should be viewed as "quasi-legal"). By contrast, Lakeridge (joined by the Federal Government as *amicus curiae*) thinks a clear-error standard should apply. In Lakeridge's view, the ultimate law-application question is all "bound up with the case-specific details of the highly

factual circumstances below"—and thus falls naturally within the domain of bankruptcy courts. Brief for Respondent 17; see Brief for United States 21 (similarly describing the mixed question as "fact-intensive").

For all their differences, both parties rightly point us to the same query: What is the nature of the mixed question here and which kind of court (bankruptcy or appellate) is better suited to resolve it? See *Miller* v. *Fenton*, 474 U. S. 104, 114 (1985) (When an "issue falls somewhere between a pristine legal standard and a simple historical fact," the standard of review often reflects which "judicial actor is better positioned" to make the decision).[3] Mixed questions are not all alike. As U. S. Bank suggests, some require courts to expound on the law, particularly by amplifying or elaborating on a broad legal standard. When that is so—when applying the law involves developing auxiliary legal principles of use in other cases—appellate courts should typically review a decision *de novo*. See *Salve Regina College* v. *Russell*, 499 U. S. 225, 231–233 (1991) (discussing appellate courts' "institutional advantages" in giving legal guidance). But as Lakeridge replies, other mixed questions immerse courts in case-specific factual issues—compelling them to marshal and weigh evidence, make credibility judgments, and otherwise address what we have (emphatically if a tad redundantly) called "multifarious, fleeting, special, narrow facts that utterly resist generalization." *Pierce* v. *Underwood*, 487 U. S. 552, 561–562 (1988) (internal quotation marks omitted). And when that is so, appellate courts should usually review a decision with deference. See *Anderson* v. *Bessemer City*, 470 U. S. 564, 574–576 (1985) (discussing trial courts' "superi-

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[3] In selecting standards of review, our decisions have also asked whether a "long history of appellate practice" supplies the answer. *Pierce* v. *Underwood*, 487 U. S. 552, 558 (1988). But we cannot find anything resembling a "historical tradition" to provide a standard for reviewing the mixed question here. *Ibid.*

ority" in resolving such issues).[4] In short, the standard of review for a mixed question all depends—on whether answering it entails primarily legal or factual work.

Now again, recall the mixed question the Bankruptcy Court confronted in this case. See *supra,* at 7. At a high level of generality, the court needed to determine whether the basic facts it had discovered (concerning Rabkin's relationships, motivations, and so on) were sufficient to make Rabkin a non-statutory insider. But the court's use of the Ninth Circuit's legal test for identifying such insiders reduced that question to a more particular one: whether the facts found showed an arm's-length transaction between Rabkin and MBP. See *ibid.*[5] And still, we can further delineate that issue just by plugging in the widely (universally?) understood definition of an arm's-length transaction: a transaction conducted as though the two parties were strangers. See, *e.g.,* Black's Law Dictionary 1726 (10th ed. 2014). Thus the mixed question becomes:

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[4] Usually but not always: In the constitutional realm, for example, the calculus changes. There, we have often held that the role of appellate courts "in marking out the limits of [a] standard through the process of case-by-case adjudication" favors *de novo* review even when answering a mixed question primarily involves plunging into a factual record. *Bose Corp.* v. *Consumers Union of United States, Inc.*, 466 U. S. 485, 503 (1984); see *Ornelas* v. *United States*, 517 U. S. 690, 697 (1996) (reasonable suspicion and probable cause under the Fourth Amendment); *Hurley* v. *Irish-American Gay, Lesbian and Bisexual Group of Boston, Inc.*, 515 U. S. 557, 567 (1995) (expression under the First Amendment); *Miller* v. *Fenton*, 474 U. S. 104, 115–116 (1985) (voluntariness of confession under the Fourteenth Amendment's Due Process Clause).

[5] A bankruptcy court applying the Ninth Circuit's test might, in another case, reach its separate, non-transactional prong: whether "the closeness of [a person's] relationship with the debtor is comparable to that of the enumerated insider classifications" in the Code. *In re Village at Lakeridge, LLC,* 814 F. 3d 993, 1001 (2016); see *supra,* at 4. We express no opinion on how an appellate court should review a bankruptcy court's application of that differently framed standard to a set of established facts.

Given all the basic facts found, was Rabkin's purchase of MBP's claim conducted as if the two were strangers to each other?

That is about as factual sounding as any mixed question gets. Indeed, application of the Ninth Circuit's arm's-length legal standard really requires what we have previously described as a "factual inference[ ] from undisputed basic facts." *Commissioner* v. *Duberstein*, 363 U. S. 278, 291 (1960) (holding that clear-error review applied to a decision that a particular transfer was a statutory "gift"). The court takes a raft of case-specific historical facts,[6] considers them as a whole, balances them one against another—all to make a determination that when two particular persons entered into a particular transaction, they were (or were not) acting like strangers. Just to describe that inquiry is to indicate where it (primarily) belongs: in the court that has presided over the presentation of evidence, that has heard all the witnesses, and that has both the closest and the deepest understanding of the record—*i.e.*, the bankruptcy court.

And we can arrive at the same point from the opposite direction—by asking how much legal work applying the arm's-length test requires. Precious little, in our view—as shown by judicial opinions addressing that concept. Our own decisions, arising in a range of contexts, have never tried to elaborate on the established idea of a transaction conducted as between strangers; nor, to our knowledge, have lower courts. See, *e.g., Jones* v. *Harris Associates L. P.*, 559 U. S. 335, 346 (2010); *Commissioner* v. *Wemyss*, 324 U. S. 303, 307 (1945); *Pepper* v. *Litton*, 308 U. S. 295, 306–307 (1939). The stock judicial method is merely to

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[6] Or, to use the more abundant description we quoted above, "multifarious, fleeting, special, narrow facts that utterly resist generalization." *Pierce*, 487 U. S., at 561–562 (internal quotation marks omitted); see *supra,* at 8.

state the requirement of such a transaction and then to do the fact-intensive job of exploring whether, in a particular case, it occurred. See, *e.g., Wemyss*, 324 U. S., at 307. Contrary to U. S. Bank's view, there is no apparent need to further develop "norms and criteria," or to devise a supplemental multi-part test, in order to apply the familiar term. Brief for Petitioner 53; see Tr. of Oral Arg. 18; *supra,* at 7. So appellate review of the arm's-length issue—even if conducted *de novo*—will not much clarify legal principles or provide guidance to other courts resolving other disputes. And that means the issue is not of the kind that appellate courts should take over.[7]

The Court of Appeals therefore applied the appropriate standard in reviewing the Bankruptcy Court's determination that Rabkin did not qualify as an insider because his transaction with MBP was conducted at arm's length. A conclusion of that kind primarily rests with a bankruptcy court, subject only to review for clear error. We accordingly affirm the judgment below.

It is so ordered.

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[7] That conclusion still leaves some role for appellate courts in this area. They of course must decide whether a bankruptcy court committed clear error in finding that a transaction was arm's length (or not). (We express no view of that aspect of the Ninth Circuit's decision because we did not grant certiorari on the question. See *supra,* at 5.) In addition, an appellate court must correct any legal error infecting a bankruptcy court's decision. So if the bankruptcy court somehow misunderstood the nature of the arm's-length query—or if it devised some novel multi-factor test for addressing that issue—an appellate court should apply *de novo* review. And finally, if an appellate court someday finds that further refinement of the arm's-length standard is necessary to maintain uniformity among bankruptcy courts, it may step in to perform that legal function. By contrast, what it may *not* do is review independently a garden-variety decision, as here, that the various facts found amount to an arm's-length (or a non-arm's-length) transaction and so do not (or do) confer insider status.

SUPREME COURT OF THE UNITED STATES

No. 15–1509

U.S. BANK NATIONAL ASSOCIATION, TRUSTEE, BY AND THROUGH CWCAPITAL ASSET MANAGEMENT LLC, PETITIONER *v.* THE VILLAGE AT LAKERIDGE, LLC

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

[March 5, 2018]

JUSTICE KENNEDY, concurring.

I join the opinion for the Court and the concurring opinion by JUSTICE SOTOMAYOR. In doing so, it seems appropriate to add these further comments.

As the Court's opinion makes clear, courts of appeals may continue to elaborate in more detail the legal standards that will govern whether a person or entity is a nonstatutory insider under the Bankruptcy Code. *Ante,* at 6, 11, n. 7. At this stage of the doctrine's evolution, this ongoing elaboration of the principles that underlie nonstatutory insider status seems necessary to ensure uniform and accurate adjudications in this area.

In particular, courts should consider the relevance and meaning of the phrase "arms-length transaction" in this bankruptcy context. See *ibid.* As courts of appeals address these issues and make more specific rulings based on the facts and circumstances of individual cases, it may be that instructive, more specifically defined rules will develop.

This leads to an additional point. Under the test that the Court of Appeals applied here, there is some room for doubt that the Bankruptcy Judge was correct in concluding that Rabkin was not an insider, especially without

further inquiry into whether the offer Bartlett made to Rabkin could and should have been made to other parties who might have paid a higher price. See *In re Village at Lakeridge, LLC*, 814 F. 3d 993, 1006 (CA9 2016) (Clifton, J., concurring in part and dissenting in part) ("[E]ven if the clear error standard applies, the finding that Rabkin was not a non-statutory insider cannot survive scrutiny"). MBP's failure to offer its claim more widely could be a strong indication that the transaction was not conducted at arm's length. As the Court is careful and correct to note, however, certiorari was not granted on this question. See *ante,* at 11, n. 7. As a result, whether the test for non-statutory insider status as formulated and used by courts in the Ninth Circuit is sufficient is not before us; and whether on these facts it was clear error to find that Rabkin was not an insider is also not before us.

The Court's holding should not be read as indicating that the non-statutory insider test as formulated by the Court of Appeals is the proper or complete standard to use in determining insider status. Today's opinion for the Court properly limits its decision to the question whether the Court of Appeals applied the correct standard of review, and its opinion should not be read as indicating that a transaction is arm's length if the transaction was negotiated simply with a close friend, without broader solicitation of other possible buyers.

SUPREME COURT OF THE UNITED STATES

No. 15–1509

U.S. BANK NATIONAL ASSOCIATION, TRUSTEE, BY AND THROUGH CWCAPITAL ASSET MANAGEMENT LLC, PETITIONER *v.* THE VILLAGE AT LAKERIDGE, LLC

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

[March 5, 2018]

JUSTICE SOTOMAYOR, with whom JUSTICE KENNEDY, JUSTICE THOMAS, and JUSTICE GORSUCH join, concurring.

The Court granted certiorari to decide "[w]hether the appropriate standard of review for determining non-statutory insider status" under the Bankruptcy Code is *de novo* or clear error. Pet. for Cert. i. To answer that question, the Court "take[s] . . . as a given" the two-prong test that the Court of Appeals for the Ninth Circuit has adopted for determining whether a person or entity is an insider. *Ante,* at 6. I join the Court's opinion in full because, within that context, I agree with the Court's analysis that a determination whether a particular transaction was conducted at arm's length is a mixed question of law and fact that should be reviewed for clear error. See *ante,* at 10–11.

I write separately, however, because I am concerned that our holding eludes the more fundamental question whether the Ninth Circuit's underlying test is correct. If that test is not the right one, our holding regarding the standard of review may be for naught. That is because the appropriate standard of review is deeply intertwined with the test being applied. As the Court puts it, "the standard of review for a mixed question all depends—on whether

answering it entails primarily legal or factual work." *Ante,* at 9.

Here, the Court identifies the Ninth Circuit as having affirmed on the basis of the second prong of its test, pursuant to which the Ninth Circuit concluded that the relevant transaction between Robert Rabkin and MBP Equity Partners was conducted at arm's length. *Ante,* at 6. Because that analysis is primarily factual in nature, the Court rightly concludes that appellate review of the Bankruptcy Court's decision is for clear error. *Ante,* at 10–11. However, if the proper inquiry did not turn solely on an arm's-length analysis but rather involved a different balance of legal and factual work, the Court may have come to a different conclusion on the standard of review.

The Court's discussion of the standard of review thus begs the question of what the appropriate test for determining non-statutory insider status is. I do not seek to answer that question, as the Court expressly declined to grant certiorari on it. I have some concerns with the Ninth Circuit's test, however, that would benefit from additional consideration by the lower courts.

As the Ninth Circuit interpreted the Code, "[a] creditor is not a non-statutory insider unless: (1) the closeness of its relationship with the debtor is comparable to that of the enumerated insider classifications in [11 U. S. C.] §101(31), *and* (2) the relevant transaction is negotiated at less than arm's length." *In re Village at Lakeridge, LLC*, 814 F. 3d 993, 1001 (2016) (emphasis added). Under this test, because prongs one and two are conjunctive, a court's conclusion that the relevant transaction was conducted at arm's length necessarily defeats a finding of non-statutory insider status, regardless of how close a person's relationship with the debtor is or whether he is otherwise comparable to a statutorily enumerated insider.[1]

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[1] Other Circuits have developed analogous rules. See, *e.g., Matter of*

It is not clear to me, however, that the Ninth Circuit has explained how this two-prong test is consistent with the plain meaning of the term "insider" as it appears in the Code. The concept of "insider" generally rests on the presumption that a person or entity alleged to be an insider is so connected with the debtor that any business conducted between them necessarily cannot be conducted at arm's length. See Black's Law Dictionary 915 (10th ed. 2014) (defining "insider" as "[a]n entity or person who is so closely related to a debtor that any deal between them will not be considered an arm's-length transaction and will be subject to close scrutiny"). Title 11 U. S. C. §101(31) defines "insider" by identifying certain individuals or entities who are considered insiders merely on the basis of their status, without regard to whether any relevant transaction is conducted at arm's length. Such an individual is not under any circumstance able to vote for a reorganization plan. See §1129(a)(10).

In contrast, under prong two of the Ninth Circuit's test, an individual who is similar to, but does not fall precisely within, one of the categories of insiders listed in §101(31) will not be considered an insider and will be able to vote under §1129(a)(10) so long as the transaction relevant to the bankruptcy proceeding is determined to have been conducted at arm's length. This would include, for example, a romantic partner of an insider, even one who in all or most respects acts like a spouse.

Given that courts have interpreted "non-statutory insiders" as deriving from the same statutory definition as the enumerated insiders in §101(31), the basis for the disparate treatment of two similar individuals is not immediately

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Holloway, 955 F. 2d 1008, 1011 (CA5 1992); *In re U. S. Medical, Inc.*, 531 F. 3d 1272, 1277–1278 (CA10 2008); *In re Winstar Communications, Inc.*, 554 F. 3d 382, 396–397 (CA3 2009). But see *In re Longview Aluminum, LLC*, 657 F. 3d 507, 510 (CA7 2011).

apparent. Lower courts have concluded that the Code's use of the term "includes" in the definition of "insider" in §101(31) signals that Congress contemplated that certain other persons or entities in addition to those listed would qualify as insiders. See *ante,* at 2. Notably, this Court has never addressed that issue directly, although the Court has held in other contexts that "the term 'including' is not one of all-embracing definition, but connotes simply an illustrative application of the general principle." *Federal Land Bank of St. Paul* v. *Bismarck Lumber Co.*, 314 U. S. 95, 100 (1941).

Assuming §101(31) encompasses such "non-statutory insiders," the only clue we have as to which persons or entities fall within that category is the list of enumerated insiders and the presumption of lack of arm's length that follows from that label. Because each of those persons or entities are considered insiders regardless of whether a particular transaction appears to have been conducted at arm's length, it is not clear why the same should not be true of non-statutory insiders. That is, an enumerated "insider" does not cease being an insider just because a court finds that a relevant transaction was conducted at arm's length. Then why should a finding that a transaction was conducted at arm's length, without more, conclusively foreclose a finding that a person or entity is a "non-statutory insider"?

Of course, courts must develop some principled method of determining what other individuals or entities fall within the term "insider" other than those expressly provided. I can conceive of at least two possible legal standards that are consistent with the understanding that insider status inherently presumes that transactions are not conducted at arm's length. First, it could be that the inquiry should focus solely on a comparison between the characteristics of the alleged non-statutory insider and the enumerated insiders, and if they share sufficient common-

alities, the alleged person or entity should be deemed an insider regardless of the apparent arm's-length nature of any transaction. Cf. *In re Longview Aluminum, LLC*, 657 F. 3d 507, 510–511 (CA7 2011) (considering only whether a manager of a debtor corporation was comparable to the enumerated insiders, regardless of whether any transaction was conducted at less-than-arm's length).

Second, it could be that the test should focus on a broader comparison that includes consideration of the circumstances surrounding any relevant transaction. If a transaction is determined to have been conducted at less-than-arm's length, it may provide strong evidence in the context of the relationship as a whole that the alleged non-statutory insider should indeed be considered an insider. Relatedly, if the transaction does appear to have been undertaken at arm's length, that may be evidence, considered together with other aspects of the parties' relationship, that the alleged non-statutory insider should not, in fact, be deemed an insider.

Neither of these conceptions reflects the Ninth Circuit's test. Rather, the Ninth Circuit considered separately whether Rabkin was comparable to an enumerated insider and whether the transaction between Rabkin and MBP was conducted at arm's length. See 814 F. 3d, at 1002–1003. Because the Ninth Circuit concluded that the transaction was undertaken at arm's length, that finding was dispositive of non-statutory insider status under their test, leading this Court, in turn, to consider the standard of review only with respect to that prong.

It is conceivable, however, that if the appropriate test were different from the one articulated by the Ninth Circuit, such as the two examples I outlined above, the applicable standard of review would be different as well. See *ante,* at 6, 9, n. 5. To make more concrete how this may play out in practice, I briefly walk through how I might apply my two proposed tests to the facts of this case.

If a comparative analysis were the right test, and assuming, *arguendo*, that it involves more legal than factual work thus resulting in *de novo* review, certain aspects of Rabkin's relationship with Kathleen Bartlett, an undisputed insider of the debtor, strike me as suggesting that Rabkin should have been designated as a non-statutory insider. Rabkin purchased the claim from MBP, but Bartlett, a member of MBP's board, facilitated the transaction. Even though Rabkin and Bartlett kept separate finances and lived separately, they shared a "romantic" relationship, see *ante,* at 4; Rabkin knew that the debtor was in bankruptcy, 814 F. 3d, at 1003; and Bartlett approached only Rabkin with the offer to sell MBP's claim, *id.,* at 1002. In a strict comparative analysis, Rabkin's interactions with Bartlett and MBP suggest that he may have been acting comparable to an enumerated insider, for example, like a relative of an officer of an insider. See §101(31)(B)(vi).

Even if the comparative analysis included a broader consideration of features of the transaction that suggest it was conducted at arm's length, and assuming, *arguendo*, that *de novo* review would apply, it is not obvious that those features would outweigh the aspects of the relationship that are concerning. Even though Rabkin purportedly lacked knowledge of the cramdown plan prior to his purchase and considered the purchase a "small investment" not warranting due diligence, 814 F. 3d, at 1003, there was no evidence of negotiation over the price, *id.,* at 1004 (Clifton, J., dissenting), or any concrete evidence that MBP obtained real value in the deal aside from the prospect of Rabkin's vote in the cramdown.[2]

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[2] Outside the context of a determination of insider status, it is possible that the nature of a transaction is relevant to assessing the integrity of bankruptcy proceedings in other ways; for example, in assessing whether a vote in a reorganization plan was "not in good faith, or was not solicited or procured in good faith." §1126(e). It troubles me here

Even if the proper test for insider status called for clear error review, it is possible that the facts of this case when considered through the lens of that test, as opposed to one focused solely on arm's length, may have warranted a finding that Rabkin was a non-statutory insider.

This is all to say that I hope that courts will continue to grapple with the role that an arm's-length inquiry should play in a determination of insider status. In the event that the appropriate test for determining non-statutory insider status is different from the one that the Ninth Circuit applied, and involves a different balance of legal and factual work than the Court addresses here, it is possible I would view the applicable standard of review differently. Because I do not read the Court's opinion as foreclosing that result, I join it in full.

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that neither the Bankruptcy Court nor the Ninth Circuit considered whether Rabkin's purchase of MBP's claim for $5,000 was for value. See App. to Pet. for Cert. 67a (bankruptcy order); *In re Village at Lakeridge, LLC*, 634 Fed. Appx. 619, 621 (2016). Cf. *In re DBSD North Am., Inc.*, 634 F. 3d 79, 104 (CA2 2011) (stating that a transferee's overpayment for claims was relevant to a good-faith determination under §1126(e)); §548(c) (providing that a transfer will not be considered constructively fraudulent, and will not be voidable under §548(a), where "a transferee . . . takes for value and in good faith"). Indeed, we have no concrete information about what benefit MBP received from the transaction aside from the prospect of Rabkin's vote in the cramdown. Of course, the Ninth Circuit's decision with respect to §1126(e) is not before this Court, but it again prompts a concern with how the courts below considered the nature of the transaction.

AMERICAN COLLEGE OF BANKRUPTCY
2018 INDUCTION EDUCATION SESSIONS

Judges' Roundtable
Saturday March 17, 2018

The SCOTUS Decision in *Merit Mgmt. v. FTI Consulting*

Hon. John E. Hoffman, Jr.
United States Bankruptcy Judge
Southern District of Ohio

Syllabus

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Timber & Lumber Co.,* 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

MERIT MANAGEMENT GROUP, LP *v.* FTI CONSULTING, INC.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 16–784. Argued November 6, 2017—Decided February 27, 2018

The Bankruptcy Code allows trustees to set aside and recover certain transfers for the benefit of the bankruptcy estate, including, as relevant here, certain fraudulent transfers "of an interest of the debtor in property." 11 U. S. C. §548(a). It also sets out a number of limits on the exercise of these avoiding powers. Central here is the securities safe harbor, which, *inter alia*, provides that "the trustee may not avoid a transfer that is a . . . settlement payment . . . made by or to (or for the benefit of) a . . . financial institution . . . or that is a transfer made by or to (or for the benefit of) a . . . financial institution . . . in connection with a securities contract." §546(e).

Valley View Downs, LP, and Bedford Downs Management Corp. entered into an agreement under which Valley View, if it got the last harness-racing license in Pennsylvania, would purchase all of Bedford Downs' stock for $55 million. Valley View was granted the license and arranged for the Cayman Islands branch of Credit Suisse to wire $55 million to third-party escrow agent Citizens Bank of Pennsylvania. The Bedford Downs shareholders, including petitioner Merit Management Group, LP, deposited their stock certificates into escrow. Citizens Bank disbursed the $55 million over two installments according to the agreement, of which petitioner Merit received $16.5 million.

Although Valley View secured the harness-racing license, it was unable to achieve its goal of opening a racetrack casino. Valley View and its parent company, Centaur, LLC, filed for Chapter 11 bankruptcy. Respondent FTI Consulting, Inc., was appointed to serve as trustee of the Centaur litigation trust. FTI then sought to avoid the transfer from Valley View to Merit for the sale of Bedford Downs'

stock, arguing that it was constructively fraudulent under §548(a)(1)(B). Merit contended that the §546(e) safe harbor barred FTI from avoiding the transfer because it was a "settlement payment . . . made by or to (or for the benefit of)" two "financial institutions," Credit Suisse and Citizens Bank. The District Court agreed with Merit, but the Seventh Circuit reversed, holding that §546(e) did not protect transfers in which financial institutions served as mere conduits.

Held: The only relevant transfer for purposes of the §546(e) safe harbor is the transfer that the trustee seeks to avoid. Pp. 9–19.

(a) Before a court can determine whether a transfer was "made by or to (or for the benefit of)" a covered entity, it must first identify the relevant transfer to test in that inquiry. Merit posits that the relevant transfer should include not only the Valley-View-to-Merit end-to-end transfer, but also all of its component parts, *i.e.*, the Credit-Suisse-to-Citizens-Bank and the Citizens-Bank-to-Merit transfers. FTI maintains that the only relevant transfer is the transfer that it sought to avoid, specifically, the overarching transfer between Valley View and Merit. Pp. 9–14.

(1) The language of §546(e) and the specific context in which that language is used support the conclusion that the relevant transfer for purposes of the safe-harbor inquiry is the transfer the trustee seeks to avoid. The first clause of the provision—"Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title"—indicates that §546(e) operates as an exception to trustees' avoiding powers granted elsewhere in the Code. The text makes clear that the starting point for the §546(e) inquiry is the expressly listed avoiding powers and, consequently, the transfer that the trustee seeks to avoid in exercising those powers. The last clause—"except under section 548(a)(1)(A) of this title"—also focuses on the transfer that the trustee seeks to avoid. Creating an exception to the exception for §548(a)(1)(A) transfers, the text refers back to a specific type of transfer that falls within the avoiding powers, signaling that the exception applies to the overarching transfer that the trustee seeks to avoid, not any component part of that transfer. This reading is reinforced by the §546 section heading, "Limitations on avoiding powers," and is confirmed by the rest of the statutory text: The provision provides that "the trustee may not avoid" certain transfers, which naturally invites scrutiny of the transfers that "the trustee . . . may avoid," the parallel language used in the avoiding powers provisions. The text further provides that the transfer that is saved from avoidance is one "that *is*" (not one that involves) a securities transaction covered under §546(e). In other words, to qualify for protection under the securities safe harbor, §546(e) provides that the otherwise avoidable

transfer itself be a transfer that meets the safe-harbor criteria. Pp. 11–13.

(2) The statutory structure also supports this reading of §546(e). The Code establishes a system for avoiding transfers as well as a safe harbor from avoidance. It is thus only logical to view the pertinent transfer under §546(e) as the same transfer that the trustee seeks to avoid pursuant to one of its avoiding powers. In an avoidance action, the trustee must establish that the transfer it seeks to set aside meets the carefully set out criteria under the substantive avoidance provisions of the Code. The defendant in that avoidance action is free to argue that the trustee failed to properly identify an avoidable transfer under the Code, including any available arguments concerning the role of component parts of the transfer. If a trustee properly identifies an avoidable transfer, however, the court has no reason to examine the relevance of 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). Pp. 13–14.

(b) The primary argument Merit advances that is moored in the statutory text—concerning Congress' 2006 addition of the parenthetical "(or for the benefit of)" to §546(e)—is unavailing. Merit contends that Congress meant to abrogate the Eleventh Circuit decision in *In re Munford, Inc.,* 98 F. 3d 604, which held that §546(e) was inapplicable to transfers in which a financial institution acted only as an intermediary. However, Merit points to nothing in the text or legislative history to corroborate its argument. A simpler explanation rooted in the text of the statute and consistent with the interpretation of §546(e) adopted here is that Congress added the "or for the benefit of" language that is common in other substantive avoidance provisions to the §546(e) safe harbor to ensure that the scope of the safe harbor and scope of the avoiding powers matched.

That reading would not, contrary to what Merit contends, render other provisions ineffectual or superfluous. Rather, it gives full effect to the text of §546(e). If the transfer the trustee seeks to avoid was made "by" or "to" a covered entity, then §546(e) will bar avoidance without regard to whether the entity acted only as an intermediary. It will also bar avoidance if the transfer was made "for the benefit of" that entity, even if it was not made "by" or "to" that entity.

Finally, Merit argues that reading the safe harbor so that its application depends on the identity of the investor and the manner in which its investment is held rather than on the general nature of the transaction is incongruous with Congress' purportedly "prophylactic" approach to §546(e). But this argument is nothing more than an attack on the text of the statute, which protects only certain transactions "made by or to (or for the benefit of)" certain covered entities.

Pp. 14–18.

(c) Applying this reading of the §546(e) safe harbor to this case yields a straightforward result. FTI sought to avoid the Valley-View-to-Merit transfer. When determining whether the §546(e) safe harbor saves that transfer from avoidance liability, the Court must look to that overarching transfer to evaluate whether it meets the safe-harbor criteria. Because the parties do not contend that either Valley View or Merit is a covered entity, the transfer falls outside of the §546(e) safe harbor. Pp. 18–19.

830 F. 3d 690, affirmed and remanded.

SOTOMAYOR, J., delivered the opinion for a unanimous Court.

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D. C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 16–784

MERIT MANAGEMENT GROUP, LP, PETITIONER *v.* FTI CONSULTING, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

[February 27, 2018]

JUSTICE SOTOMAYOR delivered the opinion of the Court.

To maximize the funds available for, and ensure equity in, the distribution to creditors in a bankruptcy proceeding, the Bankruptcy Code gives a trustee the power to invalidate a limited category of transfers by the debtor or transfers of an interest of the debtor in property. Those powers, referred to as "avoiding powers," are not without limits, however, as the Code sets out a number of exceptions. The operation of one such exception, the securities safe harbor, 11 U. S. C. §546(e), is at issue in this case. Specifically, this Court is asked to determine how the safe harbor operates in the context of a transfer that was executed via one or more transactions, *e.g.,* a transfer from A → D that was executed via B and C as intermediaries, such that the component parts of the transfer include A → B → C → D. If a trustee seeks to avoid the A → D transfer, and the §546(e) safe harbor is invoked as a defense, the question becomes: When determining whether the §546(e) securities safe harbor saves the transfer from avoidance, should courts look to the transfer that the trustee seeks to avoid (*i.e.,* A → D) to determine whether

that transfer meets the safe-harbor criteria, or should courts look also to any component parts of the overarching transfer (*i.e.,* A → B → C → D)? The Court concludes that the plain meaning of §546(e) dictates that the only relevant transfer for purposes of the safe harbor is the transfer that the trustee seeks to avoid.

I

A

Because the §546(e) safe harbor operates as a limit to the general avoiding powers of a bankruptcy trustee,[1] we begin with a review of those powers. Chapter 5 of the Bankruptcy Code affords bankruptcy trustees the authority to "se[t] aside certain types of transfers . . . and . . . recaptur[e] the value of those avoided transfers for the benefit of the estate." Tabb §6.2, p. 474. These avoiding powers "help implement the core principles of bankruptcy." *Id.,* §6.1, at 468. For example, some "deter the race of diligence of creditors to dismember the debtor before bankruptcy" and promote "equality of distribution." *Union Bank* v. *Wolas*, 502 U. S. 151, 162 (1991) (internal quotation marks omitted); see also Tabb §6.2. Others set aside transfers that "unfairly or improperly deplete . . . assets or . . . dilute the claims against those assets." 5 Collier on Bankruptcy ¶548.01, p. 548–10 (16th ed. 2017); see also Tabb §6.2, at 475 (noting that some avoiding powers are designed "to ensure that the debtor deals fairly with its creditors").

Sections 544 through 553 of the Code outline the cir-

[1] Avoiding powers may be exercised by debtors, trustees, or creditors' committees, depending on the circumstances of the case. See generally C. Tabb, Law of Bankruptcy §6.1 (4th ed. 2016) (Tabb). Because this case concerns an avoidance action brought by a trustee, we refer throughout to the trustee in discussing the avoiding power and avoidance action. The resolution of this case is not dependent on the identity of the actor exercising the avoiding power.

cumstances under which a trustee may pursue avoidance. See, *e.g.,* 11 U. S. C. §544(a) (setting out circumstances under which a trustee can avoid unrecorded liens and conveyances); §544(b) (detailing power to avoid based on rights that unsecured creditors have under nonbankruptcy law); §545 (setting out criteria that allow a trustee to avoid a statutory lien); §547 (detailing criteria for avoidance of so-called "preferential transfers"). The particular avoidance provision at issue here is §548(a), which provides that a "trustee may avoid" certain fraudulent transfers "of an interest of the debtor in property." §548(a)(1). Section 548(a)(1)(A) addresses so-called "actually" fraudulent transfers, which are "made . . . with actual intent to hinder, delay, or defraud any entity to which the debtor was or became . . . indebted." Section 548(a)(1)(B) addresses "constructively" fraudulent transfers. See *BFP* v. *Resolution Trust Corporation*, 511 U. S. 531, 535 (1994). As relevant to this case, the statute defines constructive fraud in part as when a debtor:

> "(B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
>
> "(ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation. 11 U. S. C. §548(a)(1).

If a transfer is avoided, §550 identifies the parties from whom the trustee may recover either the transferred property or the value of that property to return to the bankruptcy estate. Section 550(a) provides, in relevant part, that "to the extent that a transfer is avoided . . . the trustee may recover . . . the property transferred, or, if the court so orders, the value of such property" from "the initial transferee of such transfer or the entity for whose benefit such transfer was made," or from "any immediate or mediate transferee of such initial transferee." §550(a).

B

The Code sets out a number of limits on the exercise of these avoiding powers. See, *e.g.,* §546(a) (setting statute of limitations for avoidance actions); §§546(c)–(d) (setting certain policy-based exceptions to avoiding powers); §548(a)(2) (setting limit to avoidance of "a charitable contribution to a qualified religious or charitable entity or organization"). Central to this case is the securities safe harbor set forth in §546(e), which provides (as presently codified and in full):

> "Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7), commodity contract, as defined in section 761(4), or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title."

The predecessor to this securities safe harbor, formerly codified at 11 U. S. C. §764(c), was enacted in 1978 against the backdrop of a district court decision in a case called *Seligson* v. *New York Produce Exchange*, 394 F. Supp. 125 (SDNY 1975), which involved a transfer by a bankrupt commodity broker. See S. Rep. No. 95–989, pp. 8, 106 (1978); see also Brubaker, Understanding the Scope of the §546(e) Securities Safe Harbor Through the Concept of the

"Transfer" Sought To Be Avoided, 37 Bkrtcy. L. Letter 11–12 (July 2017). The bankruptcy trustee in *Seligson* filed suit seeking to avoid over $12 million in margin payments made by the commodity broker debtor to a clearing association on the basis that the transfer was constructively fraudulent. The clearing association attempted to defend on the theory that it was a mere "conduit" for the transmission of the margin payments. 394 F. Supp., at 135. The District Court found, however, triable issues of fact on that question and denied summary judgment, leaving the clearing association exposed to the risk of significant liability. See *id.,* at 135–136. Following that decision, Congress enacted the §764(c) safe harbor, providing that "the trustee may not avoid a transfer that is a margin payment to or deposit with a commodity broker or forward contract merchant or is a settlement payment made by a clearing organization." 92 Stat. 2619, codified at 11 U. S. C. §764(c) (repealed 1982).

Congress amended the securities safe harbor exception over the years, each time expanding the categories of covered transfers or entities. In 1982, Congress expanded the safe harbor to protect margin and settlement payments "made by or to a commodity broker, forward contract merchant, stockbroker, or securities clearing agency." §4, 96 Stat. 236, codified at 11 U. S. C. §546(d). Two years later Congress added "financial institution" to the list of protected entities. See §461(d), 98 Stat. 377, codified at 11 U. S. C. §546(e).[2] In 2005, Congress again expanded the

[2] The term "financial institution" is defined as:

"(A) a Federal reserve bank, or an entity that is a commercial or savings bank, industrial savings bank, savings and loan association, trust company, federally-insured credit union, or receiver, liquidating agent, or conservator for such entity and, when any such Federal reserve bank, receiver, liquidating agent, conservator or entity is acting as agent or custodian for a customer (whether or not a 'customer', as defined in section 741) in connection with a securities contract (as

list of protected entities to include a "financial participant" (defined as an entity conducting certain high-value transactions). See §907(b), 119 Stat. 181–182; 11 U. S. C. §101(22A). And, in 2006, Congress amended the provision to cover transfers made in connection with securities contracts, commodity contracts, and forward contracts. §5(b)(1), 120 Stat. 2697–2698. The 2006 amendment also modified the statute to its current form by adding the new parenthetical phrase "(or for the benefit of)" after "by or to," so that the safe harbor now covers transfers made "by or to (or for the benefit of)" one of the covered entities. *Id.,* at 2697.

C

With this background, we now turn to the facts of this case, which comes to this Court from the world of competitive harness racing (a form of horse racing). Harness racing is a closely regulated industry in Pennsylvania, and the Commonwealth requires a license to operate a racetrack. See *Bedford Downs Management Corp.* v. *State Harness Racing Comm'n*, 592 Pa. 475, 485–487, 926 A. 2d 908, 914–915 (2007) (*per curiam*). The number of available licenses is limited, and in 2003 two companies, Valley View Downs, LP, and Bedford Downs Management Corporation, were in competition for the last harness-racing

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defined in section 741) such customer; or

"(B) in connection with a securities contract (as defined in section 741) an investment company registered under the Investment Company Act of 1940." 11 U. S. C. §101(22).

The parties here do not contend that either the debtor or petitioner in this case qualified as a "financial institution" by virtue of its status as a "customer" under §101(22)(A). Petitioner Merit Management Group, LP, discussed this definition only in footnotes and did not argue that it somehow dictates the outcome in this case. See Brief for Petitioner 45, n. 14; Reply Brief 14, n. 6. We therefore do not address what impact, if any, §101(22)(A) would have in the application of the §546(e) safe harbor.

license in Pennsylvania.

Valley View and Bedford Downs needed the harness-racing license to open a "'racino,'" which is a clever moniker for racetrack casino, "a racing facility with slot machines." Brief for Petitioner 8. Both companies were stopped before the finish line, because in 2005 the Pennsylvania State Harness Racing Commission denied both applications. The Pennsylvania Supreme Court upheld those denials in 2007, but allowed the companies to reapply for the license. See *Bedford Downs*, 592 Pa., at 478–479, 926 A. 2d, at 910.

Instead of continuing to compete for the last available harness-racing license, Valley View and Bedford Downs entered into an agreement to resolve their ongoing feud. Under that agreement, Bedford Downs withdrew as a competitor for the harness-racing license, and Valley View was to purchase all of Bedford Downs' stock for $55 million after Valley View obtained the license.[3]

With Bedford Downs out of the race, the Pennsylvania Harness Racing Commission awarded Valley View the last harness-racing license. Valley View proceeded with the corporate acquisition required by the parties' agreement and arranged for the Cayman Islands branch of Credit Suisse to finance the $55 million purchase price as part of a larger $850 million transaction. Credit Suisse wired the $55 million to Citizens Bank of Pennsylvania, which had agreed to serve as the third-party escrow agent for the transaction. The Bedford Downs shareholders, including petitioner Merit Management Group, LP, deposited their stock certificates into escrow as well. At closing, Valley View received the Bedford Downs stock certificates, and in October 2007 Citizens Bank disbursed $47.5 million to the

[3] A separate provision of the agreement providing that Bedford Downs would sell land to Valley View for $20 million is not at issue in this case.

Bedford Downs shareholders, with $7.5 million remaining in escrow at Citizens Bank under the multiyear indemnification holdback period provided for in the parties' agreement. Citizens Bank disbursed that $7.5 million installment to the Bedford Downs shareholders in October 2010, after the holdback period ended. All told, Merit received approximately $16.5 million from the sale of its Bedford Downs stock to Valley View. Notably, the closing statement for the transaction reflected Valley View as the "Buyer," the Bedford Downs shareholders as the "Sellers," and $55 million as the "Purchase Price." App. 30.

In the end, Valley View never got to open its racino. Although it had secured the last harness-racing license, it was unable to secure a separate gaming license for the operation of the slot machines in the time set out in its financing package. Valley View and its parent company, Centaur, LLC, thereafter filed for Chapter 11 bankruptcy. The Bankruptcy Court confirmed a reorganization plan and appointed respondent FTI Consulting, Inc., to serve as trustee of the Centaur litigation trust.

FTI filed suit against Merit in the Northern District of Illinois, seeking to avoid the $16.5 million transfer from Valley View to Merit for the sale of Bedford Downs' stock. The complaint alleged that the transfer was constructively fraudulent under §548(a)(1)(B) of the Code because Valley View was insolvent when it purchased Bedford Downs and "significantly overpaid" for the Bedford Downs stock.[4] Merit moved for judgment on the pleadings under Federal Rule of Civil Procedure 12(c), contending that the §546(e) safe harbor barred FTI from avoiding the Valley View-to-Merit transfer. According to Merit, the safe harbor ap-

[4] In its complaint, FTI also sought to avoid the transfer under §544(b). See App. 20–21. The District Court did not address the claim, see 541 B. R. 850, 852–853, n. 1 (ND Ill. 2015), and neither did the Court of Appeals for the Seventh Circuit.

plied because the transfer was a "settlement payment . . . made by or to (or for the benefit of)" a covered "financial institution"—here, Credit Suisse and Citizens Bank.

The District Court granted the Rule 12(c) motion, reasoning that the §546(e) safe harbor applied because the financial institutions transferred or received funds in connection with a "settlement payment" or "securities contract." See 541 B. R. 850, 858 (ND Ill. 2015).[5] The Court of Appeals for the Seventh Circuit reversed, holding that the §546(e) safe harbor did not protect transfers in which financial institutions served as mere conduits. See 830 F. 3d 690, 691 (2016). This Court granted certiorari to resolve a conflict among the circuit courts as to the proper application of the §546(e) safe harbor.[6] 581 U. S. ___ (2017).

II

The question before this Court is 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." §546(e). The parties and the lower courts dedicate much of their attention to the definition of the words "by or to (or for the benefit of)" as used in §546(e), and to the question whether

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[5] The parties do not ask this Court to determine whether the transaction at issue in this case qualifies as a transfer that is a "settlement payment" or made in connection with a "securities contract" as those terms are used in §546(e), nor is that determination necessary for resolution of the question presented.

[6] Compare *In re Quebecor World (USA) Inc.*, 719 F. 3d 94, 99 (CA2 2013) (finding the safe harbor applicable where covered entity was intermediary); *In re QSI Holdings, Inc.*, 571 F. 3d 545, 551 (CA6 2009) (same); *Contemporary Indus. Corp.* v. *Frost*, 564 F. 3d 981, 987 (CA8 2009) (same); *In re Resorts Int'l, Inc.*, 181 F. 3d 505, 516 (CA3 1999) (same); *In re Kaiser Steel Corp.*, 952 F. 2d 1230, 1240 (CA10 1991) (same), with *In re Munford, Inc.*, 98 F. 3d 604, 610 (CA11 1996) (*per curiam*) (rejecting applicability of safe harbor where covered entity was intermediary).

there is a requirement that the "financial institution" or other covered entity have a beneficial interest in or dominion and control over the transferred property in order to qualify for safe harbor protection. In our view, those inquiries put the proverbial cart before the horse. Before a court can determine whether a transfer was made by or to or for the benefit of a covered entity, the court must first identify the relevant transfer to test in that inquiry. At bottom, that is the issue the parties dispute in this case.

On one side, Merit posits that the Court should look not only to the Valley View-to-Merit end-to-end transfer, but also to all its component parts. Here, those component parts include one transaction by Credit Suisse to Citizens Bank (*i.e.,* the transmission of the $16.5 million from Credit Suisse to escrow at Citizens Bank), and two transactions by Citizens Bank to Merit (*i.e.,* the transmission of $16.5 million over two installments by Citizens Bank as escrow agent to Merit). Because those component parts include transactions by and to financial institutions, Merit contends that §546(e) bars avoidance.

FTI, by contrast, maintains that the only relevant transfer for purposes of the §546(e) safe-harbor inquiry is the overarching transfer between Valley View and Merit of $16.5 million for purchase of the stock, which is the transfer that the trustee seeks to avoid under §548(a)(1)(B). Because that transfer was not made by, to, or for the benefit of a financial institution, FTI contends that the safe harbor has no application.

The Court agrees with FTI. The language of §546(e), the specific context in which that language is used, and the broader statutory structure all support the conclusion that the relevant transfer for purposes of the §546(e) safe-harbor inquiry is the overarching transfer that the trustee seeks to avoid under one of the substantive avoidance provisions.

A

Our analysis begins with the text of §546(e), and we look to both "the language itself [and] the specific context in which that language is used . . . ." *Robinson* v. *Shell Oil Co.*, 519 U. S. 337, 341 (1997). The pertinent language provides:

> "Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a . . . settlement payment . . . made by or to (or for the benefit of) a . . . financial institution . . . or that is a transfer made by or to (or for the benefit of) a . . . financial institution . . . in connection with a securities contract . . . , except under section 548(a)(1)(A) of this title."

The very first clause—"Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title"—already begins to answer the question. It indicates that §546(e) operates as an exception to the avoiding powers afforded to the trustee under the substantive avoidance provisions. See A. Scalia & B. Garner, Reading Law: The Interpretation of Legal Texts 126 (2012) ("A dependent phrase that begins with *notwithstanding* indicates that the main clause that it introduces or follows derogates from the provision to which it refers"). That is, when faced with a transfer that is otherwise avoidable, §546(e) provides a safe harbor notwithstanding that avoiding power. From the outset, therefore, the text makes clear that the starting point for the §546(e) inquiry is the substantive avoiding power under the provisions expressly listed in the "notwithstanding" clause and, consequently, the transfer that the trustee seeks to avoid as an exercise of those powers.

Then again in the very last clause—"except under section 548(a)(1)(A) of this title"—the text reminds us that the focus of the inquiry is the transfer that the trustee seeks to avoid. It does so by creating an exception to the

exception, providing that "the trustee may not avoid a transfer" that meets the covered transaction and entity criteria of the safe harbor, "except" for an actually fraudulent transfer under §548(a)(1)(A). 11 U. S. C. §546(e). By referring back to a specific type of transfer that falls within the avoiding power, Congress signaled that the exception applies to the overarching transfer that the trustee seeks to avoid, not any component part of that transfer.

Reinforcing that reading of the safe-harbor provision, the section heading for §546—within which the securities safe harbor is found—is: "Limitations on avoiding powers." Although section headings cannot limit the plain meaning of a statutory text, see *Florida Dept. of Revenue* v. *Piccadilly Cafeterias, Inc.*, 554 U. S. 33, 47 (2008), "they supply cues" as to what Congress intended, see *Yates* v. *United States*, 574 U. S. ___, ___ (2015) (slip op., at 10). In this case, the relevant section heading demonstrates the close connection between the transfer that the trustee seeks to avoid and the transfer that is exempted from that avoiding power pursuant to the safe harbor.

The rest of the statutory text confirms what the "notwithstanding" and "except" clauses and the section heading begin to suggest. The safe harbor provides that "the trustee may not avoid" certain transfers. §546(e). Naturally, that text invites scrutiny of the transfers that "the trustee may avoid," the parallel language used in the substantive avoiding powers provisions. See §544(a) (providing that "the trustee . . . may avoid" transfers falling under that provision); §545 (providing that "[t]he trustee may avoid" certain statutory liens); §547(b) (providing that "the trustee may avoid" certain preferential transfers); §548(a)(1) (providing that "[t]he trustee may avoid" certain fraudulent transfers). And if any doubt remained, the language that follows dispels that doubt: The transfer that the "the trustee may not avoid" is specified to be "a transfer that *is*" either a "settlement

payment" or made "in connection with a securities contract." §546(e) (emphasis added). Not a transfer that involves. Not a transfer that comprises. But a transfer that is a securities transaction covered under §546(e). The provision explicitly equates the transfer that the trustee may otherwise avoid with the transfer that, under the safe harbor, the trustee may not avoid. In other words, to qualify for protection under the securities safe harbor, §546(e) provides that the otherwise avoidable transfer itself be a transfer that meets the safe-harbor criteria.

Thus, the statutory language and the context in which it is used all point to the transfer that the trustee seeks to avoid as the relevant transfer for consideration of the §546(e) safe-harbor criteria.

B

The statutory structure also reinforces our reading of §546(e). See *Hall* v. *United States*, 566 U. S. 506, 516 (2012) (looking to statutory structure in interpreting the Bankruptcy Code). As the Seventh Circuit aptly put it, the Code "creates both a system for avoiding transfers and a safe harbor from avoidance—logically these are two sides of the same coin." 830 F. 3d, at 694; see also *Fidelity Financial Services, Inc.* v. *Fink*, 522 U. S. 211, 217 (1998) ("Section 546 of the Code puts certain limits on the avoidance powers set forth elsewhere"). Given that structure, it is only logical to view the pertinent transfer under §546(e) as the same transfer that the trustee seeks to avoid pursuant to one of its avoiding powers.

As noted in Part I–A, *supra*, the substantive avoidance provisions in Chapter 5 of the Code set out in detail the criteria that must be met for a transfer to fall within the ambit of the avoiding powers. These provisions, as Merit admits, "focus mostly on the characteristics of the transfer that may be avoided." Brief for Petitioner 28. The trustee, charged with exercising those avoiding powers, must

establish to the satisfaction of a court that the transfer it seeks to set aside meets the characteristics set out under the substantive avoidance provisions. Thus, the trustee is not free to define the transfer that it seeks to avoid in any way it chooses. Instead, that transfer is necessarily defined by the carefully set out criteria in the Code. As FTI itself recognizes, its power as trustee to define the transfer is not absolute because "the transfer identified must satisfy the terms of the avoidance provision the trustee invokes." Brief for Respondent 23.

Accordingly, after a trustee files an avoidance action identifying the transfer it seeks to set aside, a defendant in that action is free to argue that the trustee failed to properly identify an avoidable transfer under the Code, including any available arguments concerning the role of component parts of the transfer. If a trustee properly identifies an avoidable transfer, however, the court has no reason to examine the relevance of 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), see Part II–A, *supra*.

In the instant case, FTI identified the purchase of Bedford Downs' stock by Valley View from Merit as the transfer that it sought to avoid. Merit does not contend that FTI improperly identified the Valley View-to-Merit transfer as the transfer to be avoided, focusing instead on whether FTI can "ignore" the component parts at the safeharbor inquiry. Absent that argument, however, the Credit Suisse and Citizens Bank component parts are simply irrelevant to the analysis under §546(e). The focus must remain on the transfer the trustee sought to avoid.

III

A

The primary argument Merit advances that is moored in the statutory text concerns the 2006 addition of the paren-

thetical "(or for the benefit of)" to §546(e). Merit contends that in adding the phrase "or for the benefit of" to the requirement that a transfer be "made by or to" a protected entity, Congress meant to abrogate the 1998 decision of the Court of Appeals for the Eleventh Circuit in *In re Munford, Inc.*, 98 F. 3d 604, 610 (1996) (*per curiam*), which held that the §546(e) safe harbor was inapplicable to transfers in which a financial institution acted only as an intermediary. Congress abrogated *Munford*, Merit reasons, by use of the disjunctive "or," so that even if a beneficial interest, *i.e.,* a transfer "for the benefit of" a financial institution or other covered entity, is sufficient to trigger safe harbor protection, it is not necessary for the financial institution to have a beneficial interest in the transfer for the safe harbor to apply. Merit thus argues that a transaction "by or to" a financial institution such as Credit Suisse or Citizens Bank would meet the requirements of §546(e), even if the financial institution is acting as an intermediary without a beneficial interest in the transfer.

Merit points to nothing in the text or legislative history that corroborates the proposition that Congress sought to overrule *Munford* in its 2006 amendment. There is a simpler explanation for Congress' addition of this language that is rooted in the text of the statute as a whole and consistent with the interpretation of §546(e) the Court adopts. A number of the substantive avoidance provisions include that language, thus giving a trustee the power to avoid a transfer that was made to "or for the benefit of" certain actors. See §547(b)(1) (avoiding power with respect to preferential transfers "to or for the benefit of a creditor"); §548(a)(1) (avoiding power with respect to certain fraudulent transfers "including any transfer to or for the benefit of an insider . . . "). By adding the same language to the §546(e) safe harbor, Congress ensured that the scope of the safe harbor matched the scope of the

avoiding powers. For example, a trustee seeking to avoid a preferential transfer under §547 that was made "for the benefit of a creditor," where that creditor is a covered entity under §546(e), cannot now escape application of the §546(e) safe harbor just because the transfer was not "made by or to" that entity.

Nothing in the amendment therefore changed the focus of the §546(e) safe-harbor inquiry on the transfer that is otherwise avoidable under the substantive avoiding powers. If anything, by tracking language already included in the substantive avoidance provisions, the amendment reinforces the connection between the inquiry under §546(e) and the otherwise avoidable transfer that the trustee seeks to set aside.

Merit next attempts to bolster its reading of the safe harbor by reference to the inclusion of securities clearing agencies as covered entities under §546(e). Because a securities clearing agency is defined as, *inter alia*, an intermediary in payments or deliveries made in connection with securities transactions, see 15 U. S. C. §78c(23)(A) and 11 U. S. C. §101(48) (defining "securities clearing agency" by reference to the Securities Exchange Act of 1934), Merit argues that the §546(e) safe harbor must be read to protect intermediaries without reference to any beneficial interest in the transfer. The contrary interpretation, Merit contends, "would run afoul of the canon disfavoring an interpretation of a statute that renders a provision ineffectual or superfluous." Brief for Petitioner 25.

Putting aside the question whether a securities clearing agency always acts as an intermediary without a beneficial interest in a challenged transfer—a question that the District Court in *Seligson* found presented triable issues of fact in that case—the reading of the statute the Court adopts here does not yield any superfluity. Reading §546(e) to provide that the relevant transfer for purposes

of the safe harbor is the transfer that the trustee seeks to avoid under a substantive avoiding power, the question then becomes whether that transfer was "made by or to (or for the benefit of)" a covered entity, including a securities clearing agency. If the transfer that the trustee seeks to avoid was made "by" or "to" a securities clearing agency (as it was in *Seligson*), then §546(e) will bar avoidance, and it will do so without regard to whether the entity acted only as an intermediary. The safe harbor will, in addition, bar avoidance if the transfer was made "for the benefit of" that securities clearing agency, even if it was not made "by" or "to" that entity. This reading gives full effect to the text of §546(e).

B

In a final attempt to support its proposed interpretation of §546(e), Merit turns to what it perceives was Congress' purpose in enacting the safe harbor. Specifically, Merit contends that the broad language of §546(e) shows that Congress took a "comprehensive approach to securities and commodities transactions" that "was prophylactic, not surgical," and meant to "advanc[e] the interests of parties in the finality of transactions." Brief for Petitioner 41–43. Given that purported broad purpose, it would be incongruous, according to Merit, to read the safe harbor such that its application "would depend on the identity of the investor and the manner in which it held its investment" rather than "the nature of the transaction generally." *Id.,* at 33. Moreover, Merit posits that Congress' concern was plainly broader than the risk that is posed by the imposition of avoidance liability on a securities industry entity because Congress provided a safe harbor not only for transactions "to" those entities (thus protecting the entities from direct financial liability), but also "by" these entities to non-covered entities. See Reply Brief 10–14. And, according to Merit, "[t]here is no reason to believe that Congress was

troubled by the possibility that transfers *by* an industry hub could be unwound but yet was unconcerned about trustees' pursuit of transfers made *through* industry hubs." *Id.,* at 12–13 (emphasis in original).

Even if this were the type of case in which the Court would consider statutory purpose, see, *e.g., Watson* v. *Philip Morris Cos.*, 551 U. S. 142, 150–152 (2007), here Merit fails to support its purposivist arguments. In fact, its perceived purpose is actually contradicted by the plain language of the safe harbor. Because, of course, here we do have a good reason to believe that Congress was concerned about transfers "*by* an industry hub" specifically: The safe harbor saves from avoidance certain securities transactions "made by or to (or for the benefit of)" covered entities. See §546(e). Transfers "through" a covered entity, conversely, appear nowhere in the statute. And although Merit complains that, absent its reading of the safe harbor, protection will turn "on the identity of the investor and the manner in which it held its investment," that is nothing more than an attack on the text of the statute, which protects only certain transactions "made by or to (or for the benefit of)" certain covered entities.

For these reasons, we need not deviate from the plain meaning of the language used in §546(e).

IV

For the reasons stated, we conclude that the relevant transfer for purposes of the §546(e) safe harbor is the same transfer that the trustee seeks to avoid pursuant to its substantive avoiding powers. Applying that understanding of the safe-harbor provision to this case yields a straightforward result. FTI, the trustee, sought to avoid the $16.5 million Valley View-to-Merit transfer. FTI did not seek to avoid the component transactions by which that overarching transfer was executed. As such, when determining whether the §546(e) safe harbor saves the

transfer from avoidance liability, *i.e.,* whether it was "made by or to (or for the benefit of) a . . . financial institution," the Court must look to the overarching transfer from Valley View to Merit to evaluate whether it meets the safe-harbor criteria. Because the parties do not contend that either Valley View or Merit is a "financial institution" or other covered entity, the transfer falls outside of the §546(e) safe harbor. The judgment of the Seventh Circuit is therefore affirmed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

AMICUS BRIEF ON THE SCOPE OF THE BANKRUPTCY SAFE HARBOR FOR SECURITIES SETTLEMENT PAYMENTS

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Bankruptcy Code § 546(e) contains a safe harbor that prevents avoidance of a securities settlement payment, e.g., as a preferential or constructively fraudulent transfer. This amicus brief was filed in *Merit Mgmt. Grp. v. FTI Consulting, Inc.*, No. 16-784 (U.S.). The brief explains how § 546(e) rationally constrains its scope via the statutory specification that the safe harbor only applies (because it need only apply) if the "*transfer*" sought to be avoided was allegedly "*made by or to (or for the benefit of)*" a protected securities market intermediary, such as a stockbroker or a financial institution.

Ascertaining the meaning and function of that determinative scope language requires an understanding of (1) the concept of a "transfer" as the fundamental analytical transaction unit throughout the Code's avoidance provisions, and (2) the relationship between that avoidable "transfer" concept and the inextricably interrelated concepts of who that "transfer" is "made by or to (or for the benefit of)." By its express terms, § 546(e) only shields a challenged "transfer" from avoidance if (1) that transfer was "made by" a debtor-transferor who was a qualifying intermediary, "or" (2) a party with potential liability—because the challenged transfer allegedly was made "to or for the benefit of" that party—was a protected intermediary.

Key Words: bankruptcy, avoidable transfers, safe harbor, securities settlement payment

No. 16-784

In the
Supreme Court of the United States

MERIT MANAGEMENT GROUP, LP,

Petitioner,

v.

FTI CONSULTING, INC.,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

AMICI CURIAE BRIEF OF BANKRUPTCY LAW PROFESSORS RALPH BRUBAKER, BRUCE A. MARKELL, CHARLES W. MOONEY, JR., AND MARK J. ROE IN SUPPORT OF RESPONDENT

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STATEMENT OF INTEREST[1]

Amici curiae are professors who have devoted their careers to teaching, studying and writing about bankruptcy law. Their scholarship focuses on the text, structure, legislative history, and policy objectives of the Bankruptcy Code, as well as on the practical economic impact of the bankruptcy system. Accordingly, *amici* have a strong interest in the correct interpretation of the Bankruptcy Code and the effective implementation of the public policies bankruptcy law is designed to promote.

The professors filing this brief are nationally and internationally recognized scholars, each of whom has participated as an *amicus* in prior cases involving foundational issues of bankruptcy law. The statutory provision at the center of this case, Bankruptcy Code §546(e), contains a safe harbor that prevents avoidance of a securities "settlement payment" or a transfer in connection with a "securities contract," unless the transfer at issue was an actual-intent fraudulent transfer. That safe-harbor provision was originally enacted in 1982 at the instance of the SEC, to protect the securities settlement and clearing process from what has become known as "systemic risk." Unlike the decision below, however, many courts have mistakenly applied the §546(e) securities safe harbor to protect transactions that pose no threat to the integrity of

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[1] Counsel for all parties have consented to this filing. No counsel for any party authored this brief in whole or in part, and no party or their counsel made any monetary contribution toward the preparation or submission of this brief.

the security settlement and clearance process. As a result, §546(e) has become a tool for considerable mischief with far-ranging ramifications. There is a wide array of securities industry transactions that §546(e) shields from avoidance; the transfer at issue in this case is not one of them. This case presents the Court with an opportunity to resolve the disagreements among the federal courts in a way that faithfully implements the statutory language and advances the sound policy objectives Congress intended.

Ralph Brubaker is the Carl L. Vacketta Professor of Law at the University of Illinois College of Law.[2] His prior *amicus* participation in this Court includes: *Czyzewski v. Jevic Holding Corp.,* 137 S. Ct. 973 (2017); *Exec. Benefits Ins. Agency v. Arkison,* 134 S. Ct. 2165 (2014); *Law v. Siegel,* 134 S. Ct. 1188 (2014); and *Marshall v. Marshall,* 547 U.S. 293 (2006). He is the author of a recent leading commentary on the statutory provision at issue in this case. Ralph Brubaker, *Understanding the Scope of the §546(e) Securities Safe Harbor Through the Concept of the "Transfer" Sought to Be Avoided*, 37 Bkrtcy. L. Ltr. No. 7, p. 1 (July 2017), available at *http://blogs.harvard.edu/bankruptctroundable/2017/09/05/understanding-the-scope-of-the-§-546e-securities-safe-harbor-through-the-concept-of-the-transfer-sought-to-be-avoided/*.

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INTRODUCTION AND SUMMARY OF ARGUMENT

A key step in discerning the correct answer to a legal issue is asking the right questions. So, too, a key step in reaching a sound conclusion is employing the proper analysis. In this case, those keys can be found in understanding that the "transfer" is the textual analytical unit defining what the Bankruptcy Code authorizes to be avoided and for which §546(e) creates a safe harbor from avoidance.

In the decision below, the Seventh Circuit correctly perceived this basic point: "Chapter 5 [of the Code] creates both a system for avoiding transfers and a safe harbor from avoidance—logically these are two sides of the same coin. It makes sense to understand the safe harbor as applying to the transfers that are eligible for avoidance in the first place." Pet. App. 8. The "transfer" the trustee seeks to avoid is the unit of analysis for determining whether the §546(e) safe harbor shields that "transfer" from avoidance.

This analytical model is a familiar one in the law. Consider, for example, the various exceptions to the hearsay rule. Only if proffered evidence were hearsay in the first place would there be any reason to decide whether it fits within an exception. In short, exceptions apply only to matters covered by the rule.

Another analogy drawn from familiar legal principles illuminates the critical importance of identifying the correct unit of analysis. Consider the application of various categories of evidentiary privilege (*e.g.,* attorney-client, physician-patient,

clergy-congregant). Because the core analytical unit is the "communication," it is not enough simply to know the identities of the speaker and listener. Since not every communication by clients, patients, or congregants to their lawyers, doctors or religious leaders is privileged, proper analysis must focus first on whether the particular "communication" satisfies the criteria for protection.

In the context of the §546(e) safe harbor, merely identifying a securities market intermediary as a participant does not resolve the dispositive question whether a "transfer" is (or is not) protected from avoidance. The correct analytical path for this case is simple and direct. The Code authorizes certain "transfers" to be avoided. And the Code creates safe harbors that protect specified "transfers" from avoidance. Section 546(e) is one of those safe harbors. It prevents avoidance of a "transfer" that is a securities "settlement payment" or that is made in connection with a "securities contract."[3]

By its terms, §546(e) applies if the "transfer" sought to be avoided was allegedly "made by or to (or for the benefit of)" a protected securities market intermediary, such as a stockbroker or a financial institution. Accordingly, §546(e) shields a "transfer" from avoidance only if (1) that transfer was "made

[3] The applicability of the statutory terms "settlement payment" and "securities contract" is not at issue in this case. There is, however, considerable disagreement in the lower courts regarding whether particular challenged transfers are within the scope of these broadly defined, yet intractably vague, terms. This case presents no occasion for the Court to resolve that interpretive difficulty.

by" a debtor-transferor who was a qualifying intermediary, "or" (2) a party with potential liability—because the challenged transfer was allegedly made "to or for the benefit of" that party—was a protected intermediary.

That construction conforms to the statutory language and fits precisely within the Code's overall structure of avoidance liability and safe harbors. It also is fully consistent with the relevant legislative history. And it implements Congress' policy objectives in a rational, effective way.

The correctness of this approach is further reinforced by assessing the deleterious ramifications of decisions that have construed §546(e) in the way petitioner urges. Under the statutory interpretation offered by petitioner and its supporting *amici*, transfers can be inoculated from avoidance (*e.g.*, as a preferential or constructively fraudulent transfer) simply by inserting a qualified securities market intermediary as a conduit in the transactional chain. In that way, transfers that deplete the debtor's estate—transfers that should be avoided under the terms of the Code for the benefit of the debtor's unpaid creditors—are nonetheless immunized from the trustee's authorized reach. That mistaken interpretation, essentially a roadmap for laundering otherwise avoidable transfers through a financial institution acting as escrow or disbursing agent, is directly contrary to the system Congress enacted. In rejecting that approach, the Seventh Circuit correctly perceived the flaws in petitioner's proposed interpretation. The judgment below should be affirmed.

ARGUMENT

THE KEY TO UNDERSTANDING THE CORRECT SCOPE OF THE §546(e) SECURITIES SAFE HARBOR IS THROUGH THE CONCEPT OF THE "TRANSFER" THAT THE TRUSTEE SEEKS TO AVOID.

Section 546(e) of the Bankruptcy Code, 11 U.S.C. §546(e), creates an exception to a trustee's power to avoid and to recover for the benefit of creditors certain pre-bankruptcy transfers of property made by the debtor.

Code §546(e) (emphasis added), in relevant part, provides as follows:

> (e) Notwithstanding sections 544 [strong-arm and state-law avoidance powers], 545 [avoidance of statutory liens], 547 [preferential transfers], 548(a)(1)(B), and 548(b) [constructively fraudulent transfers] of this title, *the trustee may not avoid a* <u>*transfer*</u> that is a . . . settlement payment, as defined in section 101 or 741 of this title, <u>*made by or to (or for the benefit of)*</u> a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, *or* that is <u>*a transfer made by or to (or for the benefit of)*</u> a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7) . . . that is made before

> the commencement of the case, except under section 548(a)(1)(A) [actual-intent fraudulent transfers] of this title.

The correct resolution of this case requires an accurate understanding of (1) the concept of a "transfer" as the fundamental transactional unit in the Bankruptcy Code's avoiding-power provisions and (2) the relationship between the concept of an avoidable "transfer" and the inextricably interrelated concepts of who that "transfer" is "made by or to (or for the benefit of)."

A. The Fundamental Transactional Unit in the Bankruptcy Code's Avoidance Provisions is a "Transfer."

The various avoiding-power provisions of the Code authorize a bankruptcy trustee to "avoid any *transfer* of an interest of the debtor in property" meeting defined criteria.[4] Section 101(54)(D) defines "transfer" broadly to mean "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or an interest in property." That definition, however, does *not* specify the transactional unit that comprises the "transfer" the trustee can "avoid," particularly when the "transfer" is effectuated via multiple steps involving multiple entities. But the structure of the Code's avoiding-power provisions makes clear that, for analytical purposes, a "transfer" made "by" the debtor "to" a "transferee" is the fundamental and

[4] 11 U.S.C. §§544(b)(1) (giving trustee powers of individual creditors to avoid transfers under state law, *e.g.*, using state fraudulent transfer statutes), 547(b) (preferential transfers), 548(a)(1) (fraudulent transfers) (emphasis added). Some of the other avoiding powers alter the operative language slightly, but nonetheless still operate to avoid a "transfer" of property. *See, e.g.,* 11 U.S.C. §§544(a) (so-called strong-arm power to "avoid any *transfer* of property of the debtor"), 549(a)(1) (power to "avoid a *transfer* of property of the [bankruptcy] estate that occurs after the commencement of the case") (emphasis added). The power to avoid statutory liens is phrased in terms of "avoid[ing] the *fixing* of a statutory lien on property of the debtor." 11 U.S.C. §545 (emphasis added). Section 101(37) defines a "lien" as a "charge against or interest in property," and §101(54)(A) defines a "transfer" to include "the creation of a lien." The "fixing" of a statutory lien, therefore, is synonymous with "transfer" of a property interest.

pervasive transactional unit. Thus, the statutorily specified criteria regarding avoidability (or not, as in the case of the §546(e) securities safe harbor) are applied to that "transfer."

1. The Code's principal avoiding powers state that the "transfer" that can be avoided is a transfer "*of an interest of the debtor in property*." *See* n.4, *supra*, and accompanying text. As this Court recognized in *Union Bank v. Wolas,* 502 U.S. 151, 152 (1991) (emphasis added) (citations omitted), this statutory language is simply a more elaborate, comprehensive expression that, for example, "Section 547(b) [the preferential transfer provision] of the Bankruptcy Code authorizes a trustee to avoid certain property transfers *made by a debtor* within 90 days before bankruptcy." *See also BFP v. Resolution Trust Corp.*, 511 U.S. 531, 535 (1994) (emphasis added) ("The constructive fraud provision at issue in this case [now Code §548(a)(1)(B)] applies to transfers *by* insolvent *debtors*").

That the Code's avoidance provisions operate on transfers made by a debtor is also explicitly acknowledged in the statutory criteria for avoidance of a transfer. For example, actual-intent fraudulent transfers are avoidable "if *the debtor* voluntarily or involuntarily *made such transfer* . . . with actual intent to hinder, delay, or defraud." 11 U.S.C. §548(a)(1)(A) (emphasis added). *See also* 11 U.S.C. §548(a)(1)(B)(ii)(IV) (emphasis added) (constructively fraudulent transfer avoidable "if *the debtor*, voluntarily or involuntarily, *made such transfer* to or for the benefit of an insider"). And the state-law avoidance power most commonly invoked via §544(b)

(including the case at bar) expressly applies only to "[a] transfer made . . . by a debtor."[5]

2. That the Code's avoiding-power provisions, by their terms, authorize avoidance of various "transfers" made "by" a debtor (as transferor) is straightforward and uncontroversial. The correlative concept embedded both in the structure of the statutory avoidance provisions and in the concept of a "transfer" as the fundamental transactional unit is, of course, that the avoidable "transfer" is one made "to" a "transferee." *See Rupp v. Markgraf*, 95 F.3d 936, 942 (10th Cir. 1996) (emphasis added) (citations

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[5] This is the operative language of states' enactment of the Uniform Fraudulent Transfer Act (UFTA) (the state law avoidance power at issue in this case) and the 2014 Uniform Voidable Transactions Act (UVTA). UFTA §§4(a), 5(a), 7A, pt. II U.L.A. 58, 129 (2006); UVTA §§4(a), 5(a), 7A, pt. II U.L.A. 20, 29 (Supp. 2017).

The same was true under the explicit statutory language of the predecessor avoiding-power provisions of the Bankruptcy Act of 1898. *See* 1898 Act §60a(1), reprinted in 3, pt. 2 Collier on Bankruptcy 731 (James Wm. Moore et al. eds., 14th ed. 1978) [hereinafter Collier (14th ed.)] (predecessor to Code §547 preference provision, stating that "[a] preference is a transfer, as defined in this Act … made … by [the] debtor" meeting specified criteria); 1898 Act §67d(2)-(3), reprinted in 4 Collier (14th ed.) at 5-6 (predecessor to Code §548 fraudulent transfer provision, applicable to "[e]very transfer made … by a debtor" meeting specified criteria); 1898 Act §70e(1), reprinted in 4A Collier (14th ed.) at 5 (predecessor to Code §544(b)(1), applicable to "[a] transfer made … by a debtor" voidable "under any Federal or State law applicable thereto"). The 1898 Act defined "transfer" broadly, in a fashion similar to the Code definition, as "every … different mode, direct or indirect, of disposing of or of parting with property or with an interest therein." 1898 Act §1(30), reprinted in 1 Collier (14th ed.) at 44.2.

omitted) ("A transfer that may be avoided under the Bankruptcy Code takes place from the debtor *to* some entity . . . a transferee").

Identifying that "transferee" and the attendant circumstances surrounding the "transfer" made "by" the debtor "to" that "transferee" is critical in determining whether that "transfer" is avoidable. For example, "§547 allows a trustee to avoid a preferential *transfer* of assets by a debtor-transferor *to a creditor-transferee* if certain conditions are met." *In re Ogden*, 314 F.3d 1190, 1196 (10th Cir. 2002) (emphasis added). *See* 11 U.S.C. §547(b)(1) (authorizing avoidance of a preferential transfer "to … a creditor"). And various §547(c) defenses to avoidance, such as the ordinary course of business defense of 11 U.S.C. §547(c)(2), also turn on identifying the "transferee" of that challenged "transfer." The same is true of the good-faith for-value defense for the "transferee" of a fraudulent "transfer." 11 U.S.C. §548(c).

3. If a transfer is avoided under any of the Code's avoidance provisions, the trustee "may recover … the property transferred, or, if the court so orders, the value of such property from the initial transferee of such transfer *or* the entity *for whose benefit* such transfer was *made."* 11 U.S.C. §550(a)(1) (emphasis added). The latter concept of beneficiary liability is also critical to understanding the meaning of the determinative "transfer made by or to (or for the benefit of)" scope language of §546(e).

Transfer "for the benefit of" liability is a very familiar idea in the law of avoidable transfers, as it has long been (and still is) embedded in the statutory cri-

teria for avoidance of a preferential transfer. Thus, Code §547(b)(1) provides that a "transfer" by a debtor can be an avoidable preferential transfer if it was made "to *or for the benefit of* a creditor." 11 U.S.C. §547(b)(1) (emphasis added).[6] Likewise, the Code's fraudulent transfer provision repeatedly invokes that same concept in referring to an avoidable "transfer to *or for the benefit of* an insider." 11 U.S.C. §548(a)(1) (emphasis added).

The Fourth Circuit succinctly explained the established meaning of transfer "for the benefit of" liability:

> The traditional examples of the "entity for whose benefit such transfer was made" are a debtor of the transferee or the guarantor of a debt owed by the bankrupt party to the transferee. In both cases, the *transfer* of an asset from the bankrupt party *to the transferee* extinguishes the liability of "the entity for whose benefit such transfer was made." Thus, we have described that entity as "'someone who receives the benefit but not the money.'"

In re Meredith, 527 F.3d 372, 375 (4th Cir. 2008) (emphasis added) (citations omitted) (quoting *In re Columbia Data Prods., Inc.,* 892 F.2d 26, 49 (4th Cir.

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[6] The predecessor provision in the 1898 Act also provided that "a transfer … of any of the property of a debtor … made … by such debtor" could be avoided if made "to *or for the benefit of* a creditor" preferred thereby. 1898 Act §60a(1) (emphasis added), reprinted in 3, pt. 2 Collier (14th ed.) at 731.

1989); *Bonded Fin. Servs., Inc. v. European Am. Bank,* 838 F.2d 890, 895 (7th Cir. 1988)).

4. Section 546(e) creates a safe harbor precluding avoidance of particular "transfers" and, in doing so, uses precisely the same terminology employed in the Code provisions it expressly references (which authorize avoidance of "transfers" made "by" a debtor "to" a transferee "or for the benefit of" a non-transferee). The symmetric consistency of the statutory language fits comfortably within the "normal rule of statutory construction that identical words used in different parts of the same act are intended to have the same meaning." *Comm'r v. Lundy,* 516 U.S. 235, 250 (1996) (citation omitted).

The most natural reading of §546(e) is therefore clear: (1) if the challenged "transfer" allegedly (a) was made "by" a debtor-transferor who is a specified securities intermediary, "or" (b) was made "to" a "transferee" ("or for the benefit of" a non-transferee) who is a protected securities intermediary, and (2) that "transfer" was a settlement payment or was made in connection with a securities contract, then §546(e) provides a complete defense to avoidance of that challenged "transfer." *See Gross v. FBL Fin. Servs., Inc.,* 557 U.S. 167, 175 (2009) ("Statutory construction must begin with the language employed by Congress and the assumption that the ordinary meaning of that language accurately expresses the legislative purpose") (citation omitted).

Moreover, that the applicability of §546(e) can only be determined by reference to the actual "transfer" at issue in a particular case—*i.e.*, the "transfer" sought to be avoided—is clearly revealed

by the fact that §546(e) is a *safe harbor exemption* from the trustee's avoiding powers. Thus, §546(e) is introduced by a dependent "notwithstanding" clause explicitly cross-referencing those statutory avoiding powers. As this Court explained in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645 (2012): "The general/specific canon is perhaps most frequently applied to statutes in which a general permission or prohibition is contradicted by a specific prohibition or permission. To eliminate the contradiction, the specific provision is construed as an exception to the general one." Accordingly, the §546(e) safe harbor excepts from avoidance "transfers" that might otherwise be challenged under the avoiding-power provisions referenced in its "notwithstanding" clause.

There is no good reason to think that "transfer" as used in the §546(e) safe harbor should be construed to refer to something other than the actual "transfer" sought to be avoided under one of the statutory avoiding powers explicitly referenced in §546(e). If so construed, the safe harbor would function in a nonsensical fashion (*i.e.*, a safe harbor exemption shielding from avoidance a "transfer" that is *not* being challenged). Indeed, petitioner acknowledged to the Seventh Circuit that the trustee in this case is "seeking avoidance and recovery" of "transfers" made "by" debtor Valley View Downs "to" petitioner Merit Management as "initial transferee," neither of whom were qualifying §546(e)

intermediaries.[7] Yet petitioner simultaneously (and incongruously) argues that those same "transfers" are shielded from avoidance under §546(e) because they must be considered to have been made "by" and "to" the two conduit financial-institution intermediaries through which those "transfers" were effectuated.

The term "transfer" in §546(e) shields from avoidance an actual "transfer" that the estate representative seeks to avoid under one of the avoiding powers explicitly referenced in §546(e). Consequently, the associated phrase "made by or to (or for the benefit of)" should also carry the "transfer"-correlative meanings that those terms carry in the avoiding-power provisions. The Code authorizes avoidance of a "transfer" made "by" a debtor "to" a "transferee" if specified conditions regarding that transfer are met. If that transfer is avoided, the transferee "to" whom the transfer was made has liability, and if that transfer was made "for the benefit of" a non-transferee, that benefitted entity is also liable. By its express terms, therefore, §546(e) shields a challenged "transfer" from avoidance only if (1) that transfer was "made by" a debtor-transferor who was a qualifying securities intermediary, "or" (2) a party with potential liability—because the challenged transfer allegedly was made "to or for the

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[7] *See* Brief of Defendant-Appellee at 5, *FTI Consulting, Inc. v. Merit Mgmt. Grp.,* 830 F.3d 690 (7th Cir. 2016) (No. 15-3388), 2016 WL 614281, at *5 ("Trustee filed suit against Merit Management … *seeking avoidance and recovery of transfers [debtor] Valley View Downs made to [petitioner] Merit Management* in the amount of $16,503,850" (emphasis added)).

benefit of" that party—was a protected securities intermediary.

In this case, as petitioner has acknowledged, the trustee seeks "avoidance and recovery" of a "transfer" made "by" debtor Valley View Downs "to" petitioner Merit Management as "transferee" (*see* n.7, *supra*) and neither debtor-transferor nor petitioner-transferee were protected §546(e) intermediaries.[8] By the express terms of §546(e), therefore, the securities safe harbor has no applicability to the "transfer" sought to be avoided in this case.

B. Legislative History Confirms Congress' Determination that the "Transfer" Sought to be Avoided is the Transactional Unit to which the §546(e) Safe Harbor is Directed.

1. The predecessor to what is now §546(e) was enacted in 1978 as §764(c) of the new Bankruptcy Code and, as many courts have recognized, that safe harbor provision "was a response to the [1975] decision in *Seligson v. New York Produce Exchange*." *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 849 n.4 (10th Cir. 1990). *See* S. Rep. No. 95-989, at 106 (1978) (citing *Seligson v. N.Y. Produce Exch.*, 394 F. Supp. 125 (S.D.N.Y. 1975)), reprinted in 1978 U.S.C.C.A.N. 5787, 5892. In *Seligson*, the trustee for a bankrupt commodities brokerage firm sought to avoid, as fraudulent transfers, margin payments the

[8] Moreover, neither petitioner nor respondent contends that the challenged "transfer" was made "for the benefit of" the two conduit financial-institution intermediaries through which that transfer was effectuated.

debtor made to the clearing association for the commodities exchange on which the debtor executed commodities trades. Whether the margin payments were avoidable turned on "whether the defendant sought to be held liable [the clearing association] is indeed a *transferee* of the fraudulent transfer," and "[t]he Association's sole contention in this regard is that it was a mere 'conduit' for the transmittal of margins." 394 F. Supp. at 127-28, 135 (emphasis added).

Seligson held that genuine issues of material fact precluded summary judgment on the question whether the challenged margin payments were made *to* the clearing association as *transferee* or, alternatively, whether the clearing association could be disregarded as a "mere conduit" that can have no avoidance liability. *Id.* at 136. Accordingly, the court permitted the trustee's suit against the clearing association (alleging that the margin payments were made "to" the clearing association as "transferee") to proceed to trial. *Id.*

Uncertainty about the application of the "mere conduit" concept and the consequent prospect for avoidance liability as a "transferee" of margin payments prompted enactment of the initial avoidance safe harbor. That statutory safe harbor provided that "the trustee may *not* avoid a *transfer* that is a margin payment *to* . . . a commodity broker or forward contract merchant." Pub. L. No. 95-598, 92 Stat. 2549, 2619 (1978) (emphasis added) (enacting 11 U.S.C. §764(c)) (superseded in 1982 by 11 U.S.C. §546(e)).

This provision gave commodity brokers and forward contract merchants (FCMs) the same protection against avoidance liability (for margin payments they received) that is available to "mere conduits," who are not liable as "transferees" of an avoidable transfer. Moreover, this provision guaranteed that protection automatically, without the uncertainty, expense, and prospective liability associated with litigating "mere conduit" status (as illustrated by the *Seligson* case).

The rationale offered in the Senate Report confirms that the initial safe harbor was designed to give commodity brokers and FCMs automatic "mere conduit" protection against any avoidance liability for receipt of a commodity margin payment: "It would be unfair to permit recovery from an innocent commodity broker since such brokers are, for the most part, simply conduits for margin payments." S. Rep. No. 95-989, at 106, reprinted in 1978 U.S.C.C.A.N. at 5892. *See* Brubaker, *supra,* at 12 (quoting CFTC official's contemporaneous explanation). Indeed, the fees such brokers charge are miniscule relative to the dollar amount of the payments at issue, so one can fully appreciate Congress' desire to shield such intermediaries from avoidance liability for those payments, particularly given the importance of such market intermediaries to the proper functioning of the commodities markets.

The concern *Seligson* created and that the original safe harbor addressed was the prospect of avoidance liability as a "transferee" for specified market intermediaries. In creating a safe harbor

from liability for those intermediaries, the statute utilized the pervasive "transfer" concept as the analytical transaction unit for determining the avoidability (or not) of commodity margin payments—preventing avoidance if the "transfer" at issue was a commodity margin payment allegedly made "to" a commodity broker or FCM as "transferee." And, of course, if the trustee conceded that the margin payment was not made "to" a protected commodity broker or FCM as "transferee" (because the commodity broker or forward contract merchant was a "mere conduit," as the defendant argued in *Seligson*), then the safe harbor obviously would not apply because "true conduits . . . may not be subject to an avoidance recovery at all, thus rendering a [safe harbor] exception unnecessary." *Zahn v. Yucaipa Capital Fund*, 218 B.R. 656, 676-77 n.31 (D.R.I. 1998) (citation omitted).

2. The original 1978 safe harbor also confirmed that the "transfer" sought to be avoided (and, thus, protected by the safe harbor) is *always* a transfer allegedly *made "by" the debtor*. As enacted in 1978, §103(d) provided as follows: "Subchapter IV of chapter 7 of this title [entitled Commodity Broker Liquidation] applies only in a case under such chapter concerning a commodity broker [as debtor] *except with respect to section 746(c)* [sic[9]] which applies to margin payments *made* *by* *any debtor* to a commodity broker or forward contract merchant."

[9] "The original reference in section 103(d) to 'section 746(c)' was a typographical error; the reference should have been to 'section 764(c).'" H.R. Rep. No. 97-420, at 3, reprinted in 1982 U.S.C.C.A.N. 583, 585.

Pub. L. No. 95-598, 92 Stat. at 2555 (emphasis added) (enacting 11 U.S.C. §103(d)) (amended in 1982, in conjunction with the enactment of 11 U.S.C. §546(e), to repeal the "except" clause). That "except" clause was necessary for the 1978 safe harbor to have full effect in protecting the specified market intermediaries from all avoidance liability for margin payments they received.

As this Court has recognized, the Code's avoidance provisions "authorize[] a trustee to avoid certain property *transfers made by a debtor*." *Union Bank v. Wolas*, 502 U.S. 151, 152 (1991) (emphasis added). If the §764(c) safe harbor applied only in commodity broker liquidation cases, it would shield only margin payments made "by" commodity brokers (who subsequently file bankruptcy). But a major category of potential avoidance liability that the safe harbor sought to eliminate was "where the bankrupt is … a customer of an FCM" or commodity broker who received the customer's prebankruptcy commodity margin payments. Frederick L. White, *The Commodity-Related Provisions of the Bankruptcy Act of 1978*, 34 Rec. Ass'n B. City N.Y. 262, 275 n.13 (1979). To protect transfers "made *by* a debtor" who was *not* a commodity broker, therefore, the safe harbor had to apply generally to commodity "margin payments *made by any debtor* to a commodity broker or forward contract merchant." Pub. L. No. 95-598, 92 Stat. at 2555 (emphasis added) (enacting 11 U.S.C. §103(d)) (amended in 1982, with the enactment of 11 U.S.C. §546(e), to repeal the "except" clause).

That particular statutory provision was rendered unnecessary by the 1982 amendment that moved the

safe harbor into the Chapter 5 provisions of general applicability to all bankruptcy cases. *See* Pub. L. No. 97-222, §2, 96 Stat. 235, 235 (1982) (repealing the "except" clause of §103(d)). Its continuing relevance flows from its clear confirmation that the avoidance safe harbor, from its very inception, operated on the same pervasive transactional unit as do all of the Code's avoidance provisions: a "transfer" made "by" a debtor as transferor "to" a "transferee." *See* 124 Cong. Rec. 34,018 (1978) (statement of Sen. DeConcini and Sen. Mathias) ("the intent of section 764 … is to provide that margin payments … previously *made by a bankrupt* to a commodity broker [or] forward contract merchant … are nonavoidable transfers by the bankrupt's trustee" (emphasis added)).

3. In 1982, at the urging and with the support of the SEC, Congress expanded the avoidance safe harbor beyond the commodities markets, to protect specified securities intermediaries from avoidance liability for any "margin payment" or "settlement payment" they received, in a newly enacted §546(d) (now §546(e)) that replaced former §764(c). Pub. L. No. 97-222, §4, 96 Stat. at 236 (enacting §546(d)); *id.* §17(c), 96 Stat. at 240 (repealing §764(c)). This expanded safe harbor also broadened the scope of non-avoidable "transfers" to include not only those allegedly made "to" a protected commodities or securities intermediary as "transferee," but also any such "transfer" allegedly made "by" a specified intermediary who has filed bankruptcy. *Id.* §4, 96 Stat. at 236 (enacting §546(d)).

With respect to that latter expansion of the safe harbor, Congress understood that it would create the

potential for unacceptable "systemic risk" if a trustee could allege that any and all margin and settlement payments passing through the hands of a bankrupt commodity or securities firm were "transfers" made "by" the debtor firm, and thus potentially avoidable. To eliminate that risk, additional protection was "necessary to prevent the insolvency of one commodity or security firm from spreading to other firms and possibl[y] threatening the collapse of the affected market." H.R. Rep. No. 97-420, at 1, reprinted in 1982 U.S.C.C.A.N. at 583. As the House Report explained, "[t]he Bankruptcy Code now expressly provides certain protections to the commodities market to protect against such a 'ripple effect.'… [F]or example, [Code §764(c)] prevents a trustee in bankruptcy from avoiding or setting aside … margin payments made *to* a commodity broker." *Id.* (emphasis added) (citation omitted). The 1982 amendments, though, "*broaden* the commodities market protections" to also protect payments made *by* a bankrupt commodity broker "and expressly extend similar protections to the securities market." *Id.* at 2 (emphasis added).

No such "ripple effect" systemic risk is implicated when *neither* the debtor (whose trustee seeks to avoid and recover the "transfer" at issue made "by" the debtor) *nor* the defendant (from whom recovery is sought as alleged transferee "to" whom the "transfer" was made) is a protected market intermediary. Not coincidentally, therefore, the statutory language Congress chose in codifying the safe harbor, by restricting its effect to a "transfer" allegedly "made by or to" a qualifying market intermediary, makes

the safe harbor entirely inapplicable to such a "transfer."[10]

4. The 2006 amendment, which remains current and governs this case, provides further protection to a qualifying intermediary against avoidance liability in connection with a margin payment, settlement payment or securities contract transfer. Congress achieved this objective by amending the "transfer" made "by or to" scope provision of §546(e) to also include the familiar concept of transfer "for the benefit of" avoidance liability. Pub. L. No. 109-390, §5(b)(1)(A), 120 Stat. 2692, 2697 (2006) (amending §546(e)). Without this amendment, it is possible that even a "mere conduit" (who can have no liability for a transfer "to" the conduit as "transferee") nonetheless may have contingent guaranty liability in connection with the transfer (*e.g.*, by virtue of the system of guaranties involved in the securities settlement and clearing process), such that the conduit could face "for the benefit of" liability exposure in connection with the challenged "transfer."[11] In protecting qualifying intermediaries from such beneficiary liability, Congress employed "transfer" made "to or for the benefit of" language that replicated statutory text in the Code's existing avoidance provisions (*see*

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[10] Petitioner's suggestion that the Court should simply ignore the 1982 legislative history regarding Congress' stated purpose in expanding the determinative scope phrase (to include any transfer made "by or to" a qualifying intermediary) is an implicit acknowledgement that petitioner's interpretation would give the securities safe harbor an immensely more expansive sweep than Congress intended.

[11] *See* Brubaker, *supra,* at 14 & nn.101, 102.

11 U.S.C. §§547(b)(1), 548(a)(1)) and even an existing avoidance safe harbor (*see* 11 U.S.C. §926(b) (enacted in 1988, significantly, well *before* the 1996 *Munford* and *Healthco* decisions discussed *infra*, p.31)).[12]

Viewing the Code's avoidance provisions as a whole, the "for the benefit of" language (added to §546(e) in 2006) refers to the firmly established concept of transfer "for the benefit of" avoidance liability. And Congress' addition of that "transfer" liability language reinforces the natural reading of §546(e)'s pre-existing "transfer made by or to" language as transferor and transferee references, in accordance with the canon of *noscitur a sociis* ("it is known by its associates"). *See, e.g., Deal v. United States,* 508 U.S. 129, 132 (1993) ("fundamental principle of statutory construction (and, indeed, of language itself) that the meaning of a word cannot be determined in isolation but must be drawn from the context in which it is used"); *see also Schindler Elevator Corp. v. United States ex rel. Kirk,* 563 U.S. 401, 409 (2011); *Gustafson v. Alloyd Co.,* 513 U.S. 561, 575 (1995).

There is ultimately only one plausible explanation for the 2006 amendment to the §546(e)

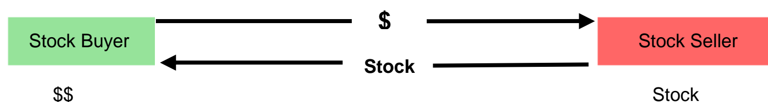
[12] The conjectural argument of petitioner and its supporting *amici* that attributes a contrary, highly idiosyncratic meaning to this "for the benefit of" language, based on the assumption that Congress secretly intended to overrule *Munford* and *Healthco*, ignores the long-established meaning of such transfer "for the benefit of" language, which has been expressly codified in bankruptcy avoidance law since the Bankruptcy Act of 1867. *See* Brubaker, *supra,* at 8, 14-15; Bankruptcy Act of 1867, ch. 176, §35, 14 Stat. 517, 534, reprinted as cumulatively amended in 10, pt. 2 Collier (14th ed.) at 1768.

safe harbor: that amendment protects qualifying intermediaries from "for the benefit of" avoidance liability in connection with a challenged "transfer" that is a margin payment, settlement payment or securities contract transfer, consistent with the accepted meaning of the phrase "for the benefit of" throughout the Code's avoidance provisions.

C. Congress' Intended Scope for the §546(e) Securities Safe Harbor

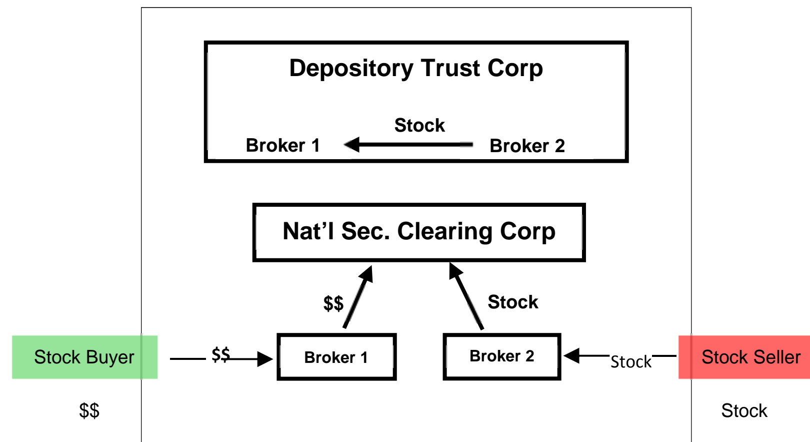
To understand why Congress enacted the §546(e) securities safe harbor and the scope thereof, as revealed by the statutory text and as confirmed by legislative history, it is helpful to consider a typical transaction involving a purchase and sale of stock, effectuated through the securities settlement and clearing system.

When a buyer purchases stock from a seller, the buyer transfers money to the seller, and the seller transfers the stock to the buyer.



These transactions do not typically occur face-to-face; the buyer and seller transact through the securities settlement and clearing system. The buyer sends cash to a securities broker; the seller moves the stock from its broker to the buyer's broker. These transactions between the buyer's and the seller's brokers are cleared by specialized institutions, typi-

cally the National Securities Clearing Corporation and the Depository Trust Corporation.[13]



The brokers who are the conduits for the securities and the cash are not highly compensated for their work, in terms of fees as a percentage of the value of the stock being purchased and sold. Congress' judgment was that the securities settlement and clearing system is a critical component of American financial infrastructure that should not be undermined. Thus, intermediaries who move securities and money to effectuate the purchase-and-sale transaction should not face any exposure for potential avoidable-transfer liability.

[13] The graphical presentation in the text is a simplified portrayal of the mechanisms by which stock and money are exchanged between Stock Buyer and Stock Seller. For more detailed information about the settlement and clearing process, see Depository Trust and Clearing Corporation, *Understanding the Settlement Process*, http://www.dtcc.com/understanding-settlement/index.html (last visited Sept. 13, 2017).

One of Congess' concerns, phrased in terms of "ripple effect" systemic risk in the 1982 legislative history, is that a bankruptcy filing by one of the conduit intermediaries (*e.g.*, Broker 1) could subject *all* settlement payments passing through the hands of Broker 1 during the period preceding the bankruptcy filing to potential challenge as avoidable "transfers" made "by" Broker 1. And since many of those payments would have also passed through the hands of other market intermediaries, suits to avoid Broker 1's settlement payments could target other intermediaries for massive liability, posing the risk of "the insolvency of one … security firm … spreading to other firms and possibly threatening the collapse of the affected market." H.R. Rep. No. 97-420, at 1, reprinted in 1982 U.S.C.C.A.N. at 583. The §546(e) securities safe harbor prevents Broker 1's bankruptcy trustee from pursuing avoidance actions based on such an allegation.

Congress' other closely-related concern, highlighted by the *Seligson* case, is that a bankruptcy filing by any of the entities involved in the purchase-and-sale transaction (*e.g.*, Stock Buyer) could subject a conduit intermediary (*e.g.*, Broker 2) to avoidable-transfer liability exposure. If Stock Buyer's bankruptcy trustee sues Broker 2 alleging that Stock Buyer made an avoidable "transfer *to*" Broker 2 as "transferee," the §546(e) securities safe harbor ensures that Broker 2 can obtain dismissal of the trustee's claim *without* having to litigate the issue of

"mere conduit" versus "transferee."[14] And after the 2006 amendment to §546(e), Broker 2 has the same protection against an allegation that Stock Buyer made an avoidable transfer "for the benefit of" Broker 2.

In contrast to those cases within the intended scope of the §546(e) securities safe harbor, consider a suit by Stock Buyer's trustee alleging that Stock

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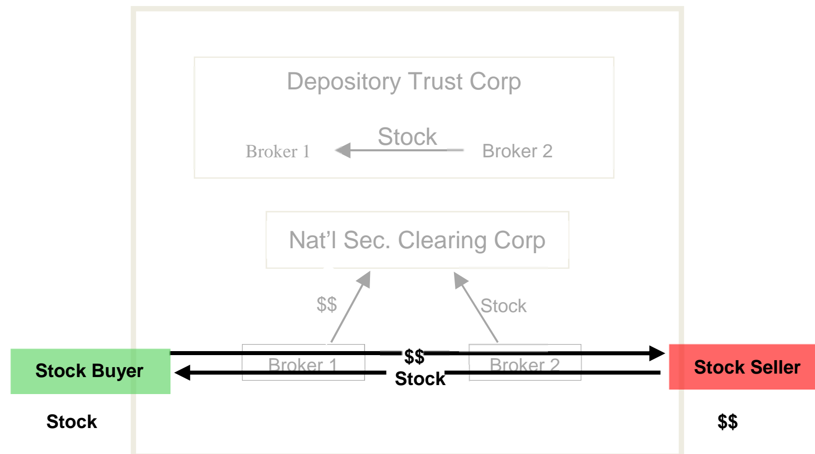
[14] Petitioner and its *amici* make repeated arguments that since qualifying §546(e) intermediaries (such as clearinghouses) are nearly always "mere conduits"—who cannot be either transferor or transferee of a challenged transfer—it makes no sense for the safe harbor to apply only in cases where a §546(e) intermediary *is, in fact,* a transferor or transferee of the challenged transfer.

Petitioner and its supporting *amici* fail to grasp the purpose and function of a *safe harbor*, a failing also revealed by their emphatic reminders that the standards for whether an intermediary will be considered a "mere conduit" or a "transferee" were not fully developed when the safe harbor was enacted (and, indeed, are still highly indeterminate). *See* Brubaker, *supra*, at 6-7, 11-12. That is true and precisely the reason why a safe harbor was necessary (as demonstrated by the *Seligson* case, involving a clearinghouse defendant). The function of the safe harbor is *not* to prevent avoidance only where a §546(e) intermediary *is, in fact,* determined to be a transferor or transferee of a challenged transfer *after* litigating "mere conduit" status; the safe harbor absolutely prevents avoidance of a transfer based on *an allegation* that a §546(e) intermediary was a transferor or transferee of the challenged transfer (such as the allegation in *Seligson*) *without* any litigation of "mere conduit" status. *See Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 848 (10th Cir. 1990) (refusing to address the "mere conduit" issue because the appellant securities broker was protected from *alleged* "transferee" liability by the §546(e) safe harbor); *see also* Brubaker, *supra*, at 15-16.

Buyer made an avoidable "transfer *to*" Stock Seller (analogous to the trustee's allegation in this case).



In that case, neither of Congress' concerns regarding protection of the securities market is implicated. There is no reason for the securites safe harbor to protect that "transfer" from avoidance, and it does not. The "transfer" sought to be avoided is not alleged to have been "made by or to (or for the benefit of)" a protected intermediary. *See generally*, Roe & Tung, *supra*, at 590-92.

D. The Seventh Circuit's Interpretation of §546(e) is the Only Rational and Practical Reading that Conforms to the Statute's Plain Meaning and Congressional Intent.

The essence of the Seventh Circuit's holding in the decision below—and of the cases on which that holding principally relied, *In re Munford, Inc.,* 98 F.3d 604, 609-10 (11th Cir. 1996) and *In re Healthco Int'l, Inc.,* 195 B.R. 971, 981-83 (Bankr. D. Mass. 1996)—is that the applicability of the §546(e) securities safe harbor cannot be determined in the abstract, but rather, can only be determined by reference to the "transfer" sought to be avoided.

In contrast, some courts have interpreted the scope of the §546(e) safe harbor in ways that neither adhere to the express terms of the Code, nor promote the salutary policy objectives Congress sought to achieve. Instead, those decisions create the risk of substantial economic mischief. The flaws in those prior decisions confirm the need to read §546(e)'s scope phrase as referring to the "transfer" sought to be avoided.

1. Unlike the more discerning opinions in *Munford, Healthco* and the decision below, the Second, Third, Sixth, and Eighth Circuits have instead viewed the text of §546(e) in isolation, relying on an invocation of "plain" meaning, but without engaging the operative statutory language. *In re Enron Creditors Recovery Corp*., 651 F.3d 329, 338-39 (2d Cir. 2011); *In re Quebecor World (USA), Inc.,* 719 F.3d 94, 98, 99-100 (2d Cir. 2013); *In re Resorts Int'l, Inc.,* 181 F.3d 505, 515-16 (3d Cir. 1999); *In re Plassein Int'l*

Corp., 590 F.3d 252, 257-58 (3d Cir. 2009); *In re QSI Holdings, Inc.,* 571 F.3d 545, 550-51 (6th Cir. 2009); *Contemporary Indus. Corp. v. Frost,* 564 F.3d 981, 986-87 (8th Cir. 2009). Those decisions ultimately run counter to a common-sense reading of the statutory language and established canons of statutory construction.

As a result, those courts have construed the §546(e) safe harbor in an indefensible fashion, which is apparent in their inconsistent descriptions of the "transfer" at issue. For example, in *Quebecor World*, the Second Circuit acknowledged that "transfers" at issue (which the creditors' committee "sought to avoid and recover") were "certain payments *made by debtor* Quebecor World (USA) Inc. *to* the appellee noteholders" who were "*not* financial institutions." 719 F.3d at 96, 99 (emphasis added).[15] Nonetheless, the court simultaneously stated that "this was a *transfer made to* a financial institution," CIBC Mellon, the disbursing agent for the noteholders. *Id.* at 99. But as the court's prior inconsistent description of the "transfer" at issue indicated, the committee was not seeking to avoid any transfer "to"

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[15] *See also In re Quebecor World (USA) Inc.,* 453 B.R. 201, 204, 212 (Bankr. S.D.N.Y. 2011) ("It is undisputed that these substantial payments were *made by [debtor]* QWUSA *to* the Noteholders … within the ninety day period" before bankruptcy, as required by Code §547(b), which "provides that the trustee of a bankruptcy estate may recover … money or property *transferred by an insolvent debtor* in the ninety days preceding bankruptcy, where the *transfer* (1) was *made to* … a creditor") (emphasis added), *aff'd*, 480 B.R. 468 (S.D.N.Y. 2012), *aff'd*, 719 F.3d 94 (2d Cir. 2013).

CIBC Mellon (and thus subject CIBC Mellon to avoidance liability) because the Committee acknowledged that "CIBC Mellon was merely a conduit." *Id.*[16]

By its inconsistent assumptions regarding the "transfer" at issue, then, the Second Circuit purported to apply §546(e) to shield from avoidance a "transfer" ("to" CIBC Mellon) that was *not* being challenged and that *no one* alleged had even been made. As one court aptly noted, "true conduits" like CIBC Mellon "may not be subject to an avoidance recovery at all, thus rendering a §546(e) exception unnecessary." *Zahn v. Yucaipa Capital Fund*, 218 B.R. 656, 676-77 n.31 (D.R.I. 1998). And, of course, the effect of the Second Circuit's confusion over the "transfer" at issue is pernicious because it obliquely extends the safe harbor of §546(e) to a "transfer" (*not* made "to" a financial institution) that the statute, by its explicit terms, does *not* protect.[17]

2. There is no merit to the efforts of petitioner and its supporting *amici* to bolster the Second (and other) Circuits' interpretation of the "transfer made

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[16] The bankruptcy court in that case made a similar self-contradictory assertion: "In determining that *the transfer in question* [*see* n.15, *supra*] qualifies for the [§546(e)] exemption, the Court must find that [it] has been *made to* a 'financial institution' …. [W]ithout question the Disputed Transfer was 'made … to … a … financial institution,' *i.e.*, CIBC Mellon as trustee for the Notes." 453 B.R. at 212 (emphasis added).

[17] Other courts adopting the same "plain"-meaning interpretation of §546(e) exhibit the same vacillation regarding the "transfer" at issue. *See* Brubaker, *supra,* at 10 & n.78. And so does petitioner in this case. *See* n.7, *supra*, and accompanying text.

by or to (or for the benefit of)" scope language of §546(e). The argument they advance makes no sense.

For, example, petitioner's principal textual argument (echoed by petitioner's *amici*) is that interpreting "by or to (or for the benefit of)" in accordance with the "transfer"-correlative meanings those words carry throughout the Code's avoidance provisions would introduce surplusage into that phrase, supposedly rendering the "or for the benefit of" language (added in 2006) a superfluous amendment with no independent meaning or purpose. That argument is incorrect.

Under the natural "transfer"-correlative reading of the determinative scope phrase, the securities safe harbor applies when the "transfer" sought to be avoided allegedly (1) was "made by" a debtor-transferor who was a qualifying intermediary, "or" (2) was made "to" a protected intermediary as "transferee," "or" (3) was made to a transferee that was *not* a protected intermediary, but was nonetheless made "for the benefit of" a protected intermediary (*e.g.*, because the intermediary had contingent guaranty liability in conjunction with the transfer). Under the established, accepted meaning of transfer "for the benefit of" liability, "the categories 'transferee' and 'entity for whose benefit such transfer was made' are mutually exclusive." *Bonded Fin. Servs., Inc. v. European Am. Bank*, 838 F.2d 890, 896 (7th Cir. 1988). Thus, by definition, the "transfer"-correlative interpretation of §546(e)'s determinative scope phrase gives independent meaning, content, and applicability to each of the disjunctive prepositions within the

compound prepositional phrase "by or to (or for the benefit of)."

In truth, it is petitioner's proposed interpretation that would inject inexplicable surplusage into §546(e)'s determinative scope phrase. Petitioner's surplusage argument depends on petitioner's highly implausible assumption (*see* n.12, *supra*) that the phrase "for the benefit of" in §546(e) does not have the established meaning that phrase carries throughout the rest of the Code's avoidance provisions (and has carried for more than 100 years). Rather, petitioner assumes (without explication) that §546(e) uses the phrase "for the benefit of" to refer to cases where a qualifying intermediary is alleged to be the *transferor or transferee* of a challenged transfer.[18] If that were true, so the argument goes, then by reading the "by or to" phrase to *also* be referring to cases where a qualifying intermediary is alleged to be the *transferor or transferee* of a challenged transfer (per the "transfer"-correlative interpretation of "by or to"), redundant surplusage would exist.

Of course, if petitioner's foundational assumption regarding the meaning of §546(e)'s "for the benefit of" phrase is incorrect, petitioner's surplusage argument collapses. Even more damning, if one were to accept petitioner's implausible reading of the "for the benefit

[18] At times, petitioner seems to take the position that this "for the benefit of" phrase refers to cases where a §546(e) intermediary is alleged to be the *transferee* of the challenged transfer. Petitioner's interpretation is equally problematic whether "for the benefit of" is assumed to refer only to a §546(e) intermediary as alleged transferee or also as alleged transferor.

of" phrase, it would introduce precisely the surplusage that petitioner decries.

Petitioner's proposed interpretation can avoid redundant surplusage *only if* the phrase "by or to" is *not* referring to cases where a qualifying intermediary is alleged to be the transferor or transferee of a challenged transfer; *viz.*, "by or to" refers *only* to cases like this one, where everyone concedes that qualifying intermediaries were involved as "mere conduits." That, of course, places petitioner in the untenable position of arguing that the phrase "transfer made by or to" is *not* referring to the *transferor or transferee* of that transfer; *i.e.*, a "transfer" is *not* made "by" the transferor and is *not* made "to" the transferee of that transfer. That argument is incompatible with petitioner's claim to be reading the text according to its plain, ordinary meaning, so petitioner never makes that aspect of its surplusage argument explicit. Petitioner's supporting *amici*, however, acknowledge that the phrase "transfer made by or to" includes within its scope the transferor and transferee of that "transfer."[19] If that is true, which it surely is, then reading the phrase "for the benefit of" as referring to the *transferor or transferee* of a challenged transfer (per the interpretation posit-

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[19] Brief for Various Former Tribune and Lyondell Shareholders as *Amici Curiae* in Support of Petitioner, at 12. *See also Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 848 (10th Cir. 1990), *aff'g* 110 B.R. 514, 516 (D. Colo.) (holding that "even if [the appellant broker] can be considered an initial transferee, [it] is … nevertheless protected [from avoidance liability] by [Code] §546(e), which exempts 'settlement payments' made *to* brokers from recovery as a [constructively] fraudulent conveyance" (emphasis added)).

ed by petitioner and its *amici*) creates redundant surplusage between the phrases "by or to" and "for the benefit of."

Petitioner's proposed interpretation of the determinative "transfer made by or to (or for the benefit of)" scope phrase of §546(e) is contrary to the accepted meaning of that language throughout the Code's avoidance provisions. For altogether valid and compelling reasons, therefore, the Seventh Circuit in the decision below rejected the statutory construction proffered by petitioner. Pet. App. 13. This Court should also reject that interpretation, which conflicts with the express language, structural context, and congressional objectives of §546(e). A decision that correctly recognizes that the "transfer" sought to be avoided is the analytical transaction unit will chart the proper path for implementing §546(e) as its language requires and as Congress intended.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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September 18, 2017

UNDERSTANDING THE SCOPE OF THE § 546(e) SECURITIES SAFE HARBOR THROUGH THE CONCEPT OF THE "TRANSFER" SOUGHT TO BE AVOIDED

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Bankruptcy Code § 546(e) contains a safe harbor that prevents avoidance of a securities settlement payment. To date, pleas for sane limits on the scope of the § 546(e) safe harbor have focused upon what kinds of transactions should be considered a "settlement payment." That language, however, is *not* the primary means by which § 546(e) both reveals its manifest object and correspondingly limits its reach thereto. Section 546(e) rationally constrains its scope via the statutory specification (the meaning of which the Supreme Court will consider in the pending case of *Merit Management Group v. FTI Consulting*) that the safe harbor only applies (because it need only apply) if the "*transfer*" sought to be avoided was allegedly "*made by or to (or for the benefit of)*" a protected securities market intermediary, such as a stockbroker or a financial institution.

Ascertaining the meaning and function of that determinative scope language requires an understanding of (1) the concept of a "transfer" as the fundamental analytical transaction unit throughout the Code's avoidance provisions, and (2) the relationship between that avoidable "transfer" concept and the inextricably interrelated concepts of who that "transfer" is "made by or to (or for the benefit of)." By its express terms, § 546(e) only shields a challenged "transfer" from avoidance if (1) that transfer was "made by" a debtor-transferor who was a qualifying intermediary, "or" (2) a party with potential liability—because the challenged transfer allegedly was made "to or for the benefit of" that party—was a protected intermediary.

UNDERSTANDING THE SCOPE OF THE § 546(e) SECURITIES SAFE HARBOR THROUGH THE CONCEPT OF THE "TRANSFER" SOUGHT TO BE AVOIDED

Ralph Brubaker[*]

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Bankruptcy Law Letter

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Understanding the Scope of the § 546(e) Securities Safe Harbor Through the Concept of the "Transfer" Sought to Be Avoided

By Ralph Brubaker

Bankruptcy Code § 546(e) contains a safe harbor that prevents avoidance of a securities "settlement payment" or a transfer in connection with a "securities contract," unless the transfer at issue was an actual-intent fraudulent transfer. That safe-harbor provision was originally enacted in 1982 at the instance of the SEC, to protect the securities settlement and clearing process from what has come to be known (after the 2008 financial crisis) as dreaded "systemic risk." Nearly all observers agree, though, that the § 546(e) securities safe harbor is being applied by many courts in a manner that protects transactions that pose no threat whatsoever to the absolute integrity of that securities settlement and clearance process, much less any systemic risk.[1] Indeed, in many courts protected transactions need not have any connection whatsoever to the securities settlement system[2] and do not even need to involve a purchase or sale of securities.[3]

As a result, § 546(e) is now itself a tool for considerable mischief. Immunizing any kind of a payment (or other transfer) by a debtor to its shareholders (or other securities holders) from all risk of attack in a subsequent bankruptcy (except actual-intent fraudulent transfer liability) is a simple matter of "laundering" the payment through a financial institution acting as an escrow or disbursing agent.[4] And in the Third Circuit, not even that indirection is necessary, as any wire transfer (or even a payment by check) will do the trick.[5] Moreover, under prevailing interpretations of § 546(e), even conventional loans could easily be structured in a manner that would give any and all payments on that debt a similar kind of avoidance inoculation.[6]

To date, the litigation and commentary that has pleaded for

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sane limits on the scope of the § 546(e) securities safe harbor has focused upon what kinds of transactions should or should not be considered a "settlement payment" within the meaning of the Bankruptcy Code—a topic thoughtfully explored by Professor Frost and Professor Kull in previous issues of *Bankruptcy Law Letter*.[7] The breadth that the courts of appeals have ascribed to that term is, indeed, startling, which raises legitimate questions regarding the soundness of the interpretative moves by which they have reached such outrageous results, e.g., concluding that fraudulent payments involving no actual securities transactions at all are nonetheless protected securities "settlement payments."[8]

All in all, though, the fixation on resolving the intractable vagueness of the term "settlement payment" has been most unfortunate, because that language is *not* the primary means by which § 546(e), by its terms, both reveals its manifest object and correspondingly limits its reach to that object. Indeed, the 2006 amendment to § 546(e) that supplemented the protection of "settlement payments," with a similar protection for an even more comprehensive category of "securities contract" transfers, largely moots the "settlement payment" controversy.[9]

The language by which the § 546(e) securities safe harbor rationally constrains its scope (for both "settlement payments" and "securities contract" transfers) is the statutory specification that the safe harbor only applies (because it need only apply) if the *"transfer"* sought to be avoided was *"made by or to (or for the benefit of)"* a protected securities market intermediary, such as a stockbroker, a securities clearing agency, or a financial institution. The meaning and function of that italicized language, in the context of the Code's avoidance provisions and the role of the securities safe harbor as an inseparable component of those avoidance provisions, has been badly misunderstood and (consequently) misconstrued by most courts. The notable exceptions are Judge Queenan's *In re Healthco International* decision,[10] which the Eleventh Circuit followed in its *Munford* decision,[11] both decided in 1996.

Other courts (including the Second,[12] Third,[13] Sixth,[14] and Eighth[15] Circuits), considering the text of § 546(e) in isolation, have summarily dismissed *Munford* and *Healthco* with an absurdly facile invocation of "plain" meaning, but without even engaging the operative statutory language nor (apparently, in many cases, comprehending or even trying to comprehend)

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the meaning *Munford* and *Healthco* actually attributed to the statutory text. Then, last summer, the Seventh Circuit agreed with *Healthco* and *Munford* in the case of *FTI Consulting, Inc. v. Merit Management Group,*[16] and the Supreme Court recently granted certiorari in *FTI Consulting* to resolve the circuit split.

The essence of the holdings in *Healthco, Munford*, and *FTI Consulting* is that the applicability of the § 546(e) securities safe harbor cannot be determined in the abstract, but rather, can only be determined by reference to the "transfer" sought to be avoided. As specified by the language of § 546(e) itself, the § 546(e) safe harbor prevents avoidance of the "transfer" at issue *only if* the "transfer" sought to be avoided is one "made by or to (or for the benefit of)" a protected securities market intermediary.

Not coincidentally, *only* when that is true does the avoidance action implicate the systemic risk concerns that motivated enactment of the securities safe harbor. And conversely, in nearly all of the cases in which the application of § 546(e) is most controversial (e.g., avoidance of LBO distributions to the debtor's shareholders), the "transfer" sought to be avoided is *not* one "made by or to (of for the benefit of)" a protected securities market intermediary. Thus, when the avoidance action is premised upon the theory (the validity of which must stand or fall on its own merits) that the "transfer" sought to be avoided was made "by" the debtor (who was not a qualifying securities market intermediary) "to" a shareholder (who, likewise, was not a protected securities market intermediary)—as in, e.g., a fraudulent transfer action whose viability depends upon "collapsing" (in the step-transaction doctrine sense) the transaction structure of an LBO—the § 546(e) securities safe harbor is entirely inapplicable and has no role whatsoever to play.

That very natural reading of the textual scope and applicability of the § 546(e) securities safe harbor—as limited to the "transfer" sought to be avoided— is quite compelling, but (oddly) it has not been fully vetted (or, for the most part, even understood) by the courts or commentators. This issue of *Bankruptcy Law Letter*, therefore, will explore the surprisingly elusive, yet critical meaning of the "transfer" protected from avoidance by § 546(e), in anticipation of the Supreme Court's consideration of that issue in *FTI Consulting*.

The "Transfer" at Issue in *FTI Consulting*

The "transfer" at issue in *FTI Consulting* is the purchase price paid by the Chapter 11 debtor (Valley View Downs) to a selling shareholder (Merit Management Group) in a corporate acquisition transaction.[17]

Before their bankruptcy filing in 2009, Valley View and its affiliated debtors were engaged in horse racing, off-track betting, and casino businesses. Their bankruptcy filing was precipitated by their efforts to develop a racing and casino facility (known as a "racino") in Pennsylvania. To do so, Valley View needed to procure, from the Pennsylvania State Harness Racing Commission (PSHRC), the last available harness racing license in the State of Pennsylvania. Bedford Downs Management Corporation, though, also submitted an application for that harness racing license, and thus, Valley View and Bedford were in a head-to-head competition for the license.

The PSHRC initially denied both Valley View's and Bedford's applications, which triggered appeals by both Valley View and Bedford that went all the way to the Pennsylvania Supreme Court. The Pennsylvania Supreme Court affirmed the PSHRC's decisions, but afforded both Valley View and Bedford an opportunity to cure any deficiencies in their original proposals and reapply.

After the Pennsylvania Supreme Court's de-

cision, Valley View proposed to acquire Bedford as a means of facilitating approval of its application for the last available harness racing license. Valley View and Bedford ultimately entered into an agreement under which Bedford agreed to withdraw its application, and then if Valley View was awarded the license, Valley View would acquire Bedford for $55 million. Pursuant to that agreement, Valley View submitted a new application and proposal, the PSHRC ultimately awarded the license to Valley View, and Valley View purchased Bedford by paying $55 million to Bedford's shareholders (which Valley View borrowed under a syndicated bank loan), including approximately $16.5 million to Merit Management (which owned approximately 30% of Bedford's stock).

To finance the proposed racino facility, including Valley View's acquisition of Bedford, Valley View borrowed money under a syndicated credit facility arranged by Credit Suisse. In order to develop the proposed racino, Valley View also needed (in addition to the harness racing license awarded by the PSHRC) a gaming license from the Pennsylvania Gaming Control Board. Valley View, however, was never awarded the necessary gaming license and, thus, was unable to repay the debt it incurred in connection with the racino project, which precipitated the Chapter 11 filing by Valley View and its affiliated debtors.

During Valley View's Chapter 11 proceedings, Valley View's estate sold (i) the site for the proposed Pennsylvania racino (which Valley View had purchased for $20 million) and (ii) Valley View's rights in the harness racing license (purchased for $55 million), at auction, to the highest bidder, for $5.6 million. Valley View's confirmed plan of reorganization established a litigation trust to pursue avoidance actions, and FTI Consulting (as trustee of that litigation trust) filed an avoidance action against Merit Management in federal district court in the Northern District of Illinois. That action sought to avoid and recover Valley View's transfer of $16.5 million to Merit Management as a constructively fraudulent transfer under Bankruptcy Code § 548(a)(1)(B) and the Pennsylvania Uniform Fraudulent Transfer Act (via Bankruptcy Code § 544(b)(1)). Merit Management sought judgment on the pleadings in that avoidance action based upon the securities safe harbor of § 546(e).

Merit Management acknowledged that the "transfers" at issue in the avoidance action (that the trustee seeks to avoid and recover) are "transfers Valley View Downs made to Merit Management in the amount of $16,503,850."[18] Nonetheless, Merit Management pointed out that "Valley View made the Transfers *through*" two financial intermediaries, "Credit Suisse and Citizens Bank of Pennsylvania ("Citizens Bank")."[19]

In particular, Citizens Bank acted as the designated escrow agent for purposes of Valley View's purchase of Bedford stock, with (1) (a) Valley View paying the $55 million aggregate purchase price to Citizens Bank and (b) Bedford shareholders depositing their stock shares with Citizens Bank, and (2) Citizens Bank then distributing (a) the stock shares to Valley View and (b) the appropriate share of the $55 million purchase price to each individual Bedford shareholder. In addition, Valley View drew on its Credit Suisse syndicated credit facility to pay the $55 million purchase price. Therefore, the precise mechanics of the $16.5 million "transfer" made by Valley View to Merit Management, in exchange for Merit Management's Bedford stock, was that Credit Suisse wired the funds to Citizens Bank, who wired the funds to Merit Management.

The district court held that the involvement of the two "financial institutions" (qualifying securities intermediaries under § 546(e)) in the challenged "transfer" by Valley View to Merit Management, in purchase of Merit Management's Bedford stock, was sufficient to invoke

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the § 546(e) securities safe harbor and, therefore, dismissed the trustee's constructive fraudulent transfer claims against Merit Management. The Seventh Circuit, though, reversed, holding that the § 546(e) securities safe harbor, by its terms, is entirely inapplicable to the trustee's claims because the "transfer" sought to be avoided as constructively fraudulent was a $16.5 million *"transfer* made *by"* Valley View *"to"* Merit Management, neither of whom were qualifying securities intermediaries under § 546(e).

The trustee in *FTI Consulting* conceded that if the "transfer" at issue in the avoidance action had been "made by or to (or for the benefit of)" Credit Suisse or Citizens Bank (each a "financial institution" within the meaning of Code §§ 546(e) & 101(22)(A)), then that "transfer" would qualify as either a "settlement payment" or a "securities contract" transfer (as those two terms have been construed by the courts of appeals) and, thus, fully protected from avoidance by the § 546(e) securities safe harbor. The *only* issue in *FTI Consulting*, therefore, is whether the "transfer" sought to be avoided as constructively fraudulent by the trustee was "made by or to (or for the benefit of)" Credit Suisse or Citizens Bank, as those operative terms are used in Code § 546(e). Resolving that issue requires an understanding of (1) the concept of a "transfer" as the fundamental transactional unit in the Bankruptcy Code's avoiding-power provisions and (2) the relationship between that avoidable "transfer" concept and the inextricably interrelated concepts of who that "transfer" is "made by or to (or for the benefit of)."

A "Transfer" as the Fundamental Transactional Unit in the Code's Avoidance Provisions

The Code's various avoiding-power provisions authorize a bankruptcy trustee (or DIP) to "avoid any *transfer* of an interest of the debtor in property" meeting the criteria specified in the particular avoidance provision.[20] The Code "defines the word 'transfer' as broadly as possible"[21] in § 101(54)(D) to mean "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or an interest in property." That definition, however, does *not* specify the transactional unit that comprises the "transfer" that the trustee (or DIP) can "avoid" (or not, depending upon whether that "transfer" meets the avoidability criteria at issue),[22] particularly when that "transfer" is effectuated via multiple steps involving multiple entities.[23] Nevertheless, the structure of the Code's avoiding-power provisions makes clear that, for analytical purposes, a "transfer" made "by" the debtor "to" a "transferee" is the fundamental and pervasive transactional unit. Thus, the statutorily specified criteria regarding avoidability (or not, as in the case of the § 546(e) securities safe harbor) are applied to that "transfer."

An Avoidable "Transfer" Made "by" the Debtor

The Code's principal avoiding powers state that the "transfer" that can be avoided is a transfer *"of an interest of the debtor in property*."[24] The courts, including the Supreme Court, readily recognize this statutory language as simply a more elaborate (and, consistent with the Code's broad definition of "transfer," a more comprehensive) way of stating, as the Supreme Court put it in *Union Bank v. Wolas*, for example, that "Section 547(b) [the preferential transfer provision] of the Bankruptcy Code authorizes a trustee to avoid certain property transfers *made by a debtor* within 90 days before bankruptcy."[25] Likewise, Justice Scalia stated in *BFP v. Resolution Trust Corp.* that "[t]he constructive fraud provision at issue [now Code § 548(a)(1)(B)] applies to transfers *by* insolvent *debtors*."[26] And a quick WESTLAW search will produce dozens of courts of appeals decisions (and hundreds of lower court decisions) with similar character-

izations of the meaning of the operative statutory language.

That the Code's avoidance provisions operate upon transfers *made by a debtor* is also explicitly acknowledged in the statutory criteria for avoidance of a transfer. For example, actual-intent fraudulent transfers are avoidable "if *the debtor*, voluntarily or involuntarily, *made such transfer* . . . with actual intent to hinder, delay, or defraud."[27] In another constructive fraud provision (not the one at issue in *BFP*), the statute declares the transfer avoidable "if *the debtor*, voluntarily or involuntarily, *made such transfer* to or for the benefit of an insider."[28] And in the state-law avoidance power most commonly invoked via Code § 544(b)—states' enactment of the Uniform Fraudulent Transfer Act (UFTA) (the state-law avoidance power at issue in *FTI Consulting*) or the 2014 Uniform Voidable Transactions Act (UVTA)—the avoidance power expressly applies only to "[a] transfer made . . . by a debtor."[29] Indeed, the same was true under the explicit statutory language of the predecessor avoiding-power provisions of the Bankruptcy Act of 1898.[30]

The avoiding-power provisions for which the § 546(e) safe harbor provides an exemption[31] only "authorize[] a trustee to avoid certain property *transfers made by a debtor*."[32] Thus, in *FTI Consulting*, defendant Merit Management fully acknowledged that the "transfers" at issue in the avoidance action (that the trustee seeks to avoid and recover) are "transfers Valley View Downs [*the debtor*] *made* to Merit Management in the amount of $16,503,850."[33] And that is true, even though the funds comprising that transfer may have originated with Valley View's lender, Credit Suisse, and may have been wired directly to the escrow agent, Citizens Bank, for distribution to Merit Management. The broad definition of "transfer" in Bankruptcy Code § 101(54), and in states' enactment of the UFTA and UVTA,[34] includes a "direct or indirect" disposition of a debtor's property. Because Valley View was borrowing the $16.5 million from Credit Suisse under the Credit Suisse syndicated loan facility, Valley View's *indirect* "transfer" of those funds (via Credit Suisse) would be "a transfer made by a debtor," Valley View, under both the Bankruptcy Code and the Pennsylvania fraudulent transfer statute.

An Avoidable "Transfer" Made "to" a "Transferee"

That the Code's avoiding-power provisions, by their terms, authorize avoidance of various "transfers" made "by" a debtor (as transferor) is straightforward and uncontroversial. The correlative concept embedded both in the analytical structure of the avoiding-power provisions and in the concept of a "transfer" as the fundamental transactional unit is, of course, that the avoidable "transfer" is one made "to" a "transferee." "A transfer that may be avoided under the Bankruptcy Code takes place from the debtor *to* some entity . . . a transferee."[35]

Identifying that "transferee" and the attendant circumstances surrounding the "transfer" made "by" the debtor "to" that "transferee" is critical in determining whether that "transfer" is avoidable (or not) under the Code's various avoiding-power provisions. For example, "§ 547 allows a trustee to avoid a preferential *transfer* of assets *by* a debtor-transferor *to* a *creditor-transferee* if certain conditions are met."[36] And various § 547(c) preference defenses (to avoidance of the "transfer" at issue), such as the ordinary course of business defense of § 547(c)(2),[37] also turn on identifying the "transferee" of that challenged "transfer." The same is true of the § 548(c) good-faith for-value defense for the "transferee" of a fraudulent "transfer."[38] Thus, as the legislative history explains, "liability is not imposed on a *transferee* to the extent that a *transferee* is protected under a provision such as section 548(c)."[39]

If a transfer is avoided, though, Code

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§ 550(a)(1) provides that "the trustee may recover . . . the property transferred, or, if the court so orders, the value of such property, from the initial *transferee* of such *transfer*." Identifying the "transferee" of a challenged "transfer," therefore, is critical to determining both (1) whether the "transfer" is avoidable, and if it is, (2) from whom the trustee (or DIP) can recover. And it is this aspect of a "transfer," as the pervasive, fundamental transactional unit in avoidance analysis, that can be difficult to apply to a multi-step transaction. "Assets routinely pass through various entities' hands en route to their ultimate destination, and determining when an entity is a transferee is tricky."[40] "The hard cases are ones where nominally the initial transfer from the debtor goes to a third party before passing to the defendant transferee, but it is debatable whether that third party intermediary had sufficient independent dominion and control over the property transferred to count as a 'transferee' for purposes of avoidance."[41]

Justice Cardozo addressed that very issue in 1930, sitting as Chief Judge of the New York Court of Appeals, in a preference suit under the Bankruptcy Act of 1898, *Carson v. Federal Reserve Bank of New York.*[42] Cardozo's opinion in that case held that the transferee "subject to a duty to make restitution of a preference," "within the meaning of the statute, is the one who is preferred, and the one who is preferred is not the mere custodian or intermediary, but the creditor . . . who receives by virtue of the preference an excessive share of the estate."[43] That is the case because "[t]he statute does not intend, of course, that the form of the transaction shall be permitted to obscure realities."[44] Rather, "the statute must be read in conformity with common-law analogies[45] to exempt an agent or custodian from the duty to account for property or money, the subject of a preferen[tial transfer], if before the coming of bankruptcy he has settled with his principal."[46] "[T]o be charged with liability" as a transferee, he "must have been more than a mere . . . conduit between the bankrupt and the creditor."[47]

Cases under the Bankruptcy Code, likewise, have looked through the form and mechanics by which a "transfer" is effectuated in discerning who is the "transferee." The seminal decision under the Code is Judge Easterbrook's opinion in *Bonded Financial Services v. European American Bank*, in which he echoed Cardozo: "When A gives a check to B as agent for C, then C is the 'initial transferee'; the agent may be disregarded."[48] Indeed, as was also the case under the Bankruptcy Act of 1898, "the Bankruptcy Code does not define 'transferee,' " and " '[t]ransferee' is not a self-defining term; it must mean something different from 'possessor' or 'holder' or 'agent,' " because "[t]o treat 'transferee' as anyone who touches the money" would produce "absurd results."[49]

There is essentially *no* disagreement in the case law "that the term 'transferee' must mean something different from anyone who simply touches the avoided transfer."[50] "The statutory term is 'transferee'—not 'recipient,' "[51] and "those who act as mere 'financial intermediaries,' 'conduits,' or 'couriers' are not [considered] transferees."[52] "[I]f couriers and other mere conduits were deemed . . . 'transferees,' " then "every courier, every bank and every escrow agent [would] be subjected to a great and unimaginable liability."[53] Thus, consistent with Cardozo's *Carson* opinion, all courts agree "that a party cannot be [a] transferee if he is a 'mere conduit.' "[54] Importantly, though, the courts have "articulat[ed] different standards for determining whether a recipient of property was a transferee or a mere conduit,"[55] and "application and articulation of the ['mere conduit' concept] has been neither consistent nor predictable."[56] As we will see, that indeterminacy is precisely the reason for enactment of the § 546(e) securities safe harbor.

As applied to the "transfer" at issue in *FTI Consulting*, though, there is apparently *no* controversy whatsoever regarding appropriate application of the "mere conduit" principle. The trustee sued Merit Management as "initial transferee" of Valley View's "transfer" of the $16.5 million purchase price for Merit Management's Bedford stock, and Merit Management did not contend otherwise. Thus, Merit Management apparently concedes that the involvement of Credit Suisse and Citizens Bank in the "transfer" of $16.5 million "by" Valley View "to" Merit Management was as "mere conduits" and *not* as transferors *nor* transferees.[57]

An Avoidable "Transfer" Made "for the Benefit of" a Non-Transferee

There is one other "transfer" concept that is critical to determining both (1) whether a "transfer" is avoidable, and if it is, (2) from whom the trustee (or DIP) can recover, and that is the concept of, as Code § 550(a)(1) formulates it, an "entity for whose benefit such transfer was made." That concept is a familiar one to the law of avoidable transfers, as it has long been (and still is) embedded in the statutory criteria for avoidance of a preferential transfer. Thus, Code § 547(b)(1) provides that a "transfer" by a debtor can be an avoidable preferential transfer if it was made "to *or for the benefit of* a creditor."[58] The Code's fraudulent transfer provision repeatedly invokes that concept in referring to an avoidable "transfer to *or for the benefit of* an insider."[59] And likewise, Code § 550(a)(1) provides that if a "transfer" is avoided under *any* of the Code's avoidance provisions, the trustee (or DIP) "may recover . . . the property transferred, or, if the court so orders, the value of such transfer from the initial transferee of such transfer *or* the entity *for whose benefit* such transfer was *made*."[60]

In the *Carson* case, Justice Cardozo also explained the meaning of similar "for the benefit of" language in the predecessor preference provision of the 1898 Act:

> "To constitute a preference, it is not necessary that the transfer be made directly to the creditor. It may be made to another [the transferee] for his benefit." National Bank of Newport v. National Herkimer County Bank, 225 U.S. 178, 184, 32 S. Ct. 633 [1912]. This will happen, for example, if bankrupts make a transfer of their assets to a creditor of their own creditor, who is thus preferred to the same extent as if the transfer had been made to him directly.[61]

And the Fourth Circuit also explained the "for the benefit of" concept (quoting *Bonded Financial*) more recently as follows:

> The traditional examples of the "entity for whose benefit such transfer was made" are a debtor of the transferee or the guarantor of a debt owed by the bankrupt party to the transferee. In both cases, the *transfer* of an asset from the bankrupt party *to the transferee* extinguishes the liability of "the entity for whose benefit such transfer was made." Thus, we have described that entity as " 'someone who receives the benefit but not the money.' "[62]

"[T]he categories 'transferee' and 'entity for whose benefit such transfer was made' are mutually exclusive."[63] Thus, the longstanding, well-known statutory "for the benefit of" concept of avoiding-power law is *not* directly implicated by the "transfer" at issue in *FTI Consulting* (since everyone apparently concedes that defendant Merit Management was the initial "transferee" of the challenged $16.5 million "transfer" made "by" debtor Valley View "to" Merit Management[64]). That statutory "for the benefit of" concept is extremely important, though, to understanding the meaning and import of the determinative "transfer made by or to (or for the benefit of)" statutory language of § 546(e) at issue in *FTI Consulting*.

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The "Transfer" Sought to Be Avoided as the Transactional Unit in the § 546(e) Securities Safe Harbor

With that background in the meaning and function of the "transfer" concept as the fundamental transactional unit in the Code's avoiding-power provisions, we can now consider the meaning of the language of Code § 546(e), and how that statutory language rationally limits the scope and applicability of the securities safe harbor, by using that same pervasive "transfer" concept.

Code § 546(e) (emphasis added), in relevant part, provides as follows:

> (e) Notwithstanding sections 544 [strong-arm and state-law avoidance powers], 545 [avoidance of statutory liens], 547 [preferential transfers], 548(a)(1)(B), and 548(b) [constructively fraudulent transfers] of this title, *the trustee may not avoid a transfer* that is a . . . settlement payment, as defined in section 101 or 741 of this title, *made by or to (or for the benefit of) a* commodity broker, forward contract merchant, stockbroker, *financial institution*, financial participant, or securities clearing agency, *or* that is *a transfer made by or to (or for the benefit of) a* commodity broker, forward contract merchant, stockbroker, *financial institution*, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7) . . . that is made before the commencement of the case, except under section 548(a)(1)(A) [actual-intent fraudulent transfers] of this title.

As is apparent on the face of the statute, then, in its *safe harbor precluding avoidance* of particular "transfers," § 546(e) employs the same language and corresponding analytical structure as the referenced Code provisions *authorizing avoidance* of "transfers." The transactional unit shielded from avoidance by § 546(e) is the same as the transactional unit on which the Code's avoiding powers operate: a "transfer." Consistent with the uniform meaning of that statutory term throughout the Code's avoiding-power provisions, therefore,[65] the most natural reading of the determinative statutory language, in the context of the entirety of the Code's avoiding-power provisions (including those avoiding powers expressly cross-referenced in § 546(e) itself),[66] is clear: (1) if the challenged "transfer" (a) was made "by" a debtor who is a specified securities intermediary, "or" (b) was made "to" a "transferee" ("or for the benefit of"[67] a non-transferee) who is a protected securities intermediary, and (2) that "transfer" is a settlement payment or is made in connection with a securities contract, then § 546(e) provides a complete defense to avoidance of that challenged "transfer."

In *FTI Consulting*, though, defendant Merit Management apparently concedes that the trustee is "seeking avoidance and recovery" of a "transfer" made "by" debtor Valley View "to" defendant Merit Management as "initial transferee,"[68] neither of whom were qualifying securities intermediaries.[69] In other words, for purposes of analysis of the "transfer" that is avoidable (or not) in *FTI Consulting*, because Credit Suisse and Citizens Bank admittedly were "mere conduits," they "may be disregarded."[70] The § 546(e) securities safe harbor, therefore, has *no* applicability whatsoever to the "transfer" sought to be avoided in *FTI Consulting*.

Moreover, that the applicability of § 546(e) can *only* be determined by reference to the actual "transfer" at issue in a particular case—i.e., the "transfer" sought to be avoided by the trustee (or DIP)—is clearly revealed by the fact that § 546(e) is a *safe harbor exemption* from the trustee's (or DIP's) avoiding powers, introduced by a dependent "notwithstanding" clause explicitly cross-referencing those statutory avoiding powers. "A dependent phrase that begins with *notwithstanding* indicates that the main clause that it introduces or follows derogates from the provision to which it refers."[71] As Justice Scalia explained in his opinion (for a unanimous Court) in the *Rad-*

LAX case, this interpretive canon is a more particularized permutatation of the general-specific canon: "The general/specific canon is perhaps most frequently applied to statutes in which a general permission or prohibition is contradicted by a specific prohibition or permission. To eliminate the contradiction, the specific provision is construed as an exception to the general one."[72] Accordingly, the § 546(e) safe harbor excepts from avoidance particular "transfers" that the trustee (or DIP) might otherwise challenge under the avoiding-power provisions referenced in its "notwithstanding" clause.

It is, of course, possible (even if not plausible) that the terms "transfer" or "made by or to (or for the benefit of)" in § 546(e) might have a meaning that departs from the consistent meaning of those words as used throughout the Code's avoiding-power provisions (for which § 546(e) provides an exception). And in the end, that is upshot (albeit unarticulated and entirely unwitting[73]) and the most that can be said in support of the truncated, conclusory, acontextual "plain"-meaning analysis of the Second, Third, Sixth, and Eighth Circuits. Common sense, though, (as reflected in the formal canons of statutory construction) strongly suggests otherwise.

There is no good reason to think that "transfer" as used in the § 546(e) safe harbor should be construed (in the abstract) to be referring to something other than the actual "transfer" sought to be avoided by the trustee (or DIP) under one of the statutory avoiding powers explicitly referenced in § 546(e).[74] Indeed, so construed, the safe harbor functions in a thoroughly nonsensical fashion (i.e., a safe harbor exemption invoked to shield from avoidance a "transfer" that is *not* being challenged?!). That perverse incongruity is apparent in the inconsistent descriptions of the "transfer" being protected from avoidance by courts that construe the scope of § 546(e) in isolation and without reference to the Code's avoidance provisions, in their entirety.

For example, in its *Quebecor World* opinion, the Second Circuit acknowledged that the "transfer" at issue (which the creditors' committee "sought to avoid and recover") was "certain payments *made by debtor* Quebecor World (USA) Inc. ("QWUSA") *to* the appellee noteholders" who were "*not* financial institutions."[75] Nonetheless, the court simultaneously, and solely for purposes of its construction of § 546(e), stated (without acknowledging or apparently even recognizing the self-contradiction) that "this was a *transfer made to* a financial institution," CIBC Mellon, the disbursing agent for the noteholders.[76] As the court's prior (inconsistent) description of the "transfer" at issue indicated, though, the committee was *not* seeking to avoid any transfer "to" CIBC Mellon (and thus subject CIBC Mellon to avoidance liability) because the Committee took the position (which no one apparently contested) that "CIBC Mellon was merely a conduit."[77] Other courts proclaiming a similarly preposterous "plain"-meaning interpretation of § 546(e) exhibit the same bemused vacillation regarding the "transfer" at issue.[78]

By its inconsistent and contradictory assumptions regarding the "transfer" at issue, then, the Second Circuit applied § 546(e) avowedly to shield from avoidance a "transfer" ("to" CIBC Mellon) that was *not* being challenged and that *no one* alleged had even been made. As one court aptly noted, "true conduits" like CIBC Mellon "may not be subject to avoidance recovery at all, thus rendering a § 546(e) exception unnecessary."[79] And, of course, the end result of the Second Circuit's confusion as to the "transfer" at issue is pernicious because it obliquely extends the safe harbor of § 546(e) to a "transfer" (*not* made "to" a financial institution) that the statute, by its explicit terms, does *not* protect.

The meaning and function of the term

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"transfer" in § 546(e), in context, obviously is to shield from avoidance an actual "transfer" that the estate representative seeks to avoid under one of the avoiding powers explicitly referenced in § 546(e). Consequently, the associated phrase "made by or to (or for the benefit of)" should also carry the "transfer"-correlative meanings that those terms carry in the Code's avoiding-power provisions.[80] The Code's avoiding powers authorize avoidance of a "transfer" made "by" a debtor "to" a "transferee" if specified conditions regarding that transfer are met. If that transfer is avoided, the transferee "to" whom the transfer was made has liability, and if that transfer was made "for the benefit of" a non-transferee, that benefitted entity is also liable. By its express terms, therefore, Code § 546(e) only shields a challenged "transfer" from avoidance (1) if that transfer was "made by" a debtor-transferor who was a qualifying securities intermediary, or (2) a party with potential liability—because the challenged transfer allegedly was made "to or for the benefit of" that party—was a protected securities intermediary.

That this is the scope of the § 546(e) safe harbor, as revealed by an attentive, holistic reading of the statutory text, is fully consistent with (and thus confirmed by) the legislative record surrounding the enactment of (and amendments to) that provision.

Legislative History Regarding the "Transfer" Sought to Be Avoided as the Transactional Unit in the § 546(e) Safe Harbor

The Seligson *Case and the Predecessor Safe Harbor Provision: A Challenged "Transfer" Made "to" a Protected Intermediary as "Transferee"*

The predecessor provision to what is now Code § 546(e) was enacted in 1978 as § 764(c) of the new Bankruptcy Code, and as many courts have recognized, that safe harbor provision "was a response to the [1975] decision in *Seligson v. New York Produce Exchange*."[81] In that case, the trustee for a bankrupt commodities brokerage firm sought to avoid, as fraudulent transfers, margin payments that the debtor firm had made to the clearing association for the commodities exchange on which the debtor firm executed commodities trades. Whether the margin payments were avoidable turned on "whether the defendant sought to be held liable [the clearing association] is indeed a *transferee* of the fraudulent transfer,"[82] and "[t]he Association's sole contention in this regard is that it was a mere 'conduit' for the transmittal of margins."[83]

The *Seligson* court, though, held that there were genuine issues of material fact as to whether the challenged margin payments were made "to" the clearing association as "transferee" thereof or, alternatively, whether the clearing association was a "mere conduit" who "may be disregarded"[84] and who, thus, had no avoidance liability. The court, therefore, refused to grant the clearing association summary judgment and, thus, permitted the trustee's suit against the clearing association (alleging that the margin payments were made "to" the clearing association as "transferee") to go forward for trial on the merits.

Uncertainty regarding the application of the "mere conduit" concept and the consequent prospect for avoidance liability as a "transferee" of margin payments, then, is what prompted enactment of the initial avoidance safe harbor. That statutory safe harbor provided that "the trustee may *not* avoid a *transfer* that is a margin payment *to* . . . a commodity broker or forward contract merchant."[85]

This provision, therefore, automatically gave to commodity brokers and forward contract merchants, as regards commodity margin payments they received, the same protection available to "mere conduits" (i.e., no avoidance liability), but *without* the uncertainty, expense,

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and prospective liability associated with litigating "mere conduit" status (as illustrated by the *Seligson* case). Thus, even if the trustee alleged that a commodity margin payment that a commodity broker or forward contract merchant received was an avoidable "transfer" made "to" that protected entity as "transferee" (as alleged in *Seligson*), the new safe harbor protected those entities from any avoidance liability.

That the initial safe harbor was designed to essentially give commodity brokers and forward contract merchants automatic "mere conduit" protection against any avoidance liability for receipt of a commodity margin payment, is confirmed by the rationale proffered for this avoidance safe harbor in the Senate Report: "It would be unfair to permit recovery from an innocent commodity broker since such brokers are, for the most part, simply conduits for margin payments."[86] As explained contemporaneously by special counsel at the CFTC's Division of Trading and Markets:

> The *Seligson* case is troublesome because it could lead to a recovery of substantial margin payments, which could in turn impair the financial stability of [a commodity broker or forward contract merchant (FCM)] from which the payments are recovered. To a large extent, [these intermediaries] are simply conduits for the margin payments they receive; much of the amount recovered by a trustee would have to be paid out of [the intermediary's] capital, and the financial problems thereby created could have a domino-type effect on other firms.[87]

The concern *Seligson* created and that was addressed by the original safe harbor was the prospect of avoidance liability as a "transferee" for the specified market intermediaries. And in creating its safe harbor from liability for those intermediaries, by its terms, the statute utilized the pervasive "transfer" concept as the analytical transaction unit for determining the avoidability (or not) of commodity margin payments—preventing avoidance if the "transfer" at issue was a commodity margin payment that the trustee alleged was made "to" a commodity broker or forward contract merchant as "transferee." And, of course, if the trustee conceded that the commodity margin payment was *not* made "to" a protected commodity broker or forward contract merchant as "transferee" (because the commodity broker or forward contract merchant was a "mere conduit"—the defendant's argument in *Seligson*), then the safe harbor obviously would have no application whatsoever, because "true conduits . . . may not be subject to avoidance recovery at all, thus rendering a [safe harbor] exception unnecessary."[88]

The Predecessor Safe Harbor: A Challenged "Transfer" Made "by" the Debtor

The original safe harbor also contained statutory confirmation that the "transfer" sought to be avoided under the Code's avoiding powers (and, thus, protected from avoidance by the safe harbor) is *always* a transfer allegedly *made "by" the debtor*.

Code § 103 governs the applicability of various chapters and subchapters of the Bankruptcy Code to the various kinds of bankruptcy cases (i.e., Chapter 7, 9, 11, 12, 13, and 15 cases) maintained pursuant to the Code. As originally enacted in 1978, Code § 103(d) provided as follows: "Subchapter IV of chapter 7 of this title [entitled Commodity Broker Liquidation] applies only in a case under such chapter concerning a commodity broker [as debtor] *except with respect to section 746(c)* [sic[89]] which applies to margin payments *made by any debtor* to a commodity broker or forward contract merchant."[90] That "except" clause was necessary for the safe harbor to have full effect in protecting the specified market intermediaries from any and all avoidance liability for commodity margin payments they received.

Again, as the Supreme Court has recognized, the Code's avoidance provisions "authorize[] a trustee to avoid certain property *transfers*

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made by a debtor."[91] If the § 764(c) safe harbor were only applicable in commodity broker liquidation cases, therefore, the safe harbor would only shield from avoidance commodity margin payments made "by" commodity brokers (who subsequently file bankruptcy). A major category of potential avoidance liability that the safe harbor sought to eliminate, though, was cases "where the bankrupt is a customer of an FCM" or commodity broker who received the customer's prebankruptcy commodity margin payments.[92] To protect these transfers "made *by* a debtor" who was *not* a commodity broker, therefore, the safe harbor had to apply generally to commodity "margin payments *made by any debtor* to a commodity broker or forward contract merchant.[93]

That particular statutory provision was rendered unnecessary by the 1982 amendment that moved the safe harbor into the Chapter 5 provisions of general applicability to all bankruptcy cases.[94] Its lasting relevance though, is in its clear confirmation that the avoidance safe harbor, from its very inception, operated upon the same pervasive transactional unit as do all of the Code's avoidance provisions: a "transfer" made "by" a debtor as transferor "to" a "transferee."

The 1982 Enactment of § 546(e): A "Transfer" Made "by or to" a Qualifying Intermediary

In 1982, with the urging and support of the SEC, Congress expanded the avoidance safe harbor beyond the commodities markets, to also protect specified securities intermediaries from avoidance liability for any "margin payment" or "settlement payment" they received, in a newly enacted § 546(d) (now § 546(e)) that replaced the former § 764(c).[95] This expanded safe harbor also broadened the scope of these non-avoidable "transfers" to include not only those allegedly made "to" a protected commodities or securities intermediary as "transferee," but also any such "transfer" allegedly made "by" a specified intermediary who has filed bankruptcy.[96]

With respect to that latter expansion of the safe harbor, a trustee's allegation that any and all margin payments and settlement payments passing through the hands of a bankrupt commodity or securities firm were "transfers" made "by" the debtor firm, and thus potentially avoidable, was perceived to hold the potential for unacceptable "systemic risk" that the expanded safe harbor would eliminate. As explained in the House Report, that additional protection was "necessary to prevent the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected market."[97] "The Bankruptcy Code now expressly provides certain protections to the commodities market to protect against such a 'ripple effect.' . . . [F]or example, [Code § 764(c)] prevents a trustee in bankruptcy from avoiding or setting aside . . . margin payments made *to* a commodity broker."[98] The 1982 amendments "*broaden* the commodities market protections" to also protect payments made *by* a broker "and expressly extend similar protections to the securities market."[99]

Of course, as many have pointed out, no such "ripple effect" systemic risk is implicated when *neither* the debtor (whose trustee is seeking to avoid and recover the "transfer" at issue made "by" the debtor) *nor* the defendant (from whom recovery is sought as alleged transferee "to" whom the "transfer" was made) is a protected market intermediary. Not coincidentally, then, the statutory language Congress chose in codifying the safe harbor, by restricting its effect to a "transfer" allegedly "made by or to" a qualifying market intermediary, makes the safe harbor *entirely inapplicable* to such a "transfer."

The 2006 Amendment: Protecting Qualifying Intermediaries from "for the Benefit of" Liability

In the 2006 amendment to the § 546(e) safe harbor, in order to further protect a qualifying intermediary from potential avoidance liability in connection with a margin payment, settlement payment or securities contract transfer, the "transfer" made "by or to" scope provision was amended to also include the familiar concept of "for the benefit of" avoidance liability.[100] Indeed, it is entirely within the realm of realistic possibility that even a "mere conduit" (who can have *no* liability for a transfer "to" the conduit as "transferee") nonetheless may have contingent guaranty liability in connection with the transfer (e.g., by virtue of the system of guaranties involved in the securities settlement and clearing process[101]), such that the conduit *could* have "for the benefit of" liability exposure in connection with the challenged "transfer."[102] In protecting qualifying intermediaries from such beneficiary liability, Congress employed "transfer" made "to or for the benefit of" language that replicated statutory text in the Code's existing avoidance provisions[103] and even an existing avoidance safe harbor.[104]

Considering the Code's avoidance provisions as a whole, then, one can readily recognize this "for the benefit of" language (added to § 546(e) in 2006) for what it is: an obvious reference to the firmly established concept of "for the benefit of" avoidance liability. Moreover, use of that "transfer" liability language also reinforces reading the "by or to" language as transferor and transferee references, in accordance with the *noscitur a sociis* ("it is known by its associates") canon of statutory construction.[105]

Considering the meaning of the "transfer made by or to (or for the benefit of)" language of § 546(e) in the abstract, without reference (indeed, contrary) to the settled, accepted meaning of those terms as used throughout the Code's avoidance provisions (per the Second, Third, Sixth, and Eighth Circuits), one must resort to rank (and implausible) speculation to explain the meaning and purpose of the 2006 amendment. For example, the Second Circuit, while acknowledging that there is nothing in the legislative history even remotely supporting its facile surmise, nonetheless mused that because "[t]he phrase 'or for the benefit of' was added by the 2006 amendments to section 546(e)," "*after* the circuit split arose, it is arguable that Congress intended to resolve the split with the 2006 Amendments" by statutorily overruling *Munford*.[106] That attribution of such a novel, highly idiosyncratic meaning to the "for the benefit of" language, tellingly reveals how badly those courts have misread (indeed, distorted) *Munford* and (by extension) the statutory text of § 546(e).

Courts that dismiss *Munford* invariably do so with the assertion that "*Munford* seems to have read into section 546(e) the requirement that the [qualifying intermediary] obtain a 'beneficial interest' in the funds they handle for the section to be applicable. This requirement is not explicit in section 546,"[107] which "does not expressly require that the financial institution obtain a beneficial interest in the funds."[108] *Munford*, however, did *not* read a non-textual "beneficial interest" requirement into § 546(e). *Munford* was clearly interpreting the "transfer" made "by or to" scope language of § 546(e), and the court interpreted the meaning of that statutory text in accordance with the *uniform view* of *all* courts that a "mere conduit" is *neither* a transferor *nor* transferee of a challenged "transfer":

> Here, the [challenged] transfers/payments were made *by* [debtor] Munford *to* shareholders. None of the entities listed in sections 546(e) . . . made or received a transfer/payment. Thus, section 546(e) is not applicable.
>
> True, a section 546(e) financial institution was presumptively involved in this transaction. But the bank here was nothing more than an intermediary or conduit.[109]

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The *Munford* court stated that "the bank never acquired a beneficial interest in . . . the funds"[110] simply as a concise and intuitive locution of the debtor's allegation (which the defendants apparently did not contest) that the bank was a mere conduit. Thus, the "transfer" sought to be avoided by the debtor (*and* sought to be shielded from avoidance under § 546(e) by the defendants) was neither "made *by*" nor "*to*" the bank as either transferor or transferee, because such a conduit "may be disregarded."[111]

Significantly, the so-called "requirement" of a "beneficial interest" that courts have incorrectly attributed to *Munford* is *not* the test used by most courts (or even the Eleventh Circuit) to determine whether an intermediary is a mere conduit. Rather, the dominant tests are the "dominion" test and the "control" test.[112] Hence, if the purpose of the 2006 amendment to § 546(e) were, in actuality, to legislatively overrule *Munford*, Congress undoubtedly would *not* have used the "for the benefit of" language to effectively achieve that object. Moreover, it likely would have made some mention of that objective in the House Report explaining the amendment. The only explanation offered, however, was that "[t]his amendment conforms the language of Sections 546(e) and 546(f) to the language in 546(g), regarding the protection of transfers in connection with swap agreements."[113]

The only plausible explanation for the 2006 amendment to § 546(e) is that it protects qualifying intermediaries from "for the benefit of" avoidance liability in connection with a challenged "transfer" that is a margin payment, settlement payment or securities contract transfer, consistent with the accepted meaning of such "for the benefit of" language throughout the Code's avoidance provisions. Courts' resistance (or obliviousness) to the obvious meaning and implications of that 2006 amendment is a revealing indication of how bizarre, careless, and utterly wrong-headed is their simplistic interpretation of the determinative "transfer made by or to (or for the benefit of)" scope language of § 546(e).

LBOs and the § 546(e) Securities Safe Harbor

The context in which courts' overly broad interpretation of the scope of § 546(e) has generated perhaps the most litigation (and controversy) has been fraudulent transfer challenges to leveraged buyout transactions (LBOs). "A leveraged buyout can take a myriad of different forms."[114] This gist of these transactions, though, tends to follow a similar pattern:

> For example, an acquirer may form a wholly owned subsidiary to buy the stock of the debtor (D) from D's pre-acquisition shareholders. The acquirer finances the acquisition by borrowing a significant portion of the purchase price, liability which it causes D to assume after closing, secured by D's assets. The (borrowed) purchase price is then remitted to D's pre-acquisition shareholders. This has the effect of giving D's selling shareholders the benefit of using D's assets to gain priority over D's pre-bankruptcy unsecured creditors, who will be junior in right to LBO lenders with liens encumbering D's assets.[115]

"[I]f the deal sours and [D] descends into bankruptcy, . . . [s]ince [D]'s shareholders receive money while [D]'s [unsecured] creditors lose their claim to [D]'s remaining assets, unsuccessful leveraged buyouts often lead to fraudulent conveyance litigation alleging" that D's assets were transferred "without receiving fair value in return," a constructively fraudulent transfer.[116] Such constructive fraud suits can be filed "against all parties to the transaction, including [the] selling shareholders,"[117] and it is with respect to the avoidance claims against the selling shareholders that applicability and scope of the § 546(e) securities safe harbor is implicated.[118]

The first court of appeals decision to address the § 546(e) safe harbor as applied to an LBO,

the Tenth Circuit's *Kaiser Steel* case[119]—a virtual replay of the *Seligson* litigation that inspired enactment of the safe harbor[120]—perfectly illustrates the proper scope and applicability of the securities safe harbor. Subsequent cases, however (with the notable exceptions of *Healthco*, *Munford*, and now *FTI Consulting*), have unmoored the operation of the safe harbor from the statutory text confining its purview to a "transfer" allegedly "made by or to" a protected securities intermediary.

Kaiser Steel *and the "Mere Conduit" Controversy*

At issue in *Kaiser* were the LBO payments made to selling shareholders, and in its complaint, Kaiser named "as defendants over 150 brokerage houses."[121] Broker-defendants sought to be held liable "for funds received by them in payment for Kaiser shares held by the broker in street name for its customer" moved for summary judgment.[122] Those broker-defendants made two arguments. First, as in *Seligson,* each argued that "it should be found to be a 'mere conduit' and not subject to liability as an initial transferee."[123] Second, and alternatively, "[t]hey argue[d] the applicability of [Code] § 546(e) which limits the trustee's ability to recover either a margin or settlement payment from a broker."[124]

On the mere conduit issue, the bankruptcy court (after an extended discussion of the doctrine) ultimately concluded that the brokers "may be held liable as initial transferees for funds received by them in payment for Kaiser shares held by the broker in street name for its customer."[125] On appeal, though, the district court reversed, holding "that the undisputed facts in this case indicate that [the appealing broker] was nothing more than a mere conduit."[126] On further appeal to the Tenth Circuit, that court refused to address the "mere conduit" issue, instead affirming the district court on the ground that "even if [the appealing broker] can be considered an initial transferee, [it] is . . . nevertheless protected [from avoidance liability] by [Code] § 546(e), which exempts 'settlement payments' made *to* brokers from recovery as a [constructively] fraudulent conveyance."[127]

Indeed, allowing such a protected securities intermediary to escape avoidance liability (as an alleged "transferee" of a settlement payment made "to" that protected securities intermediary) *without* having to litigate the "mere conduit" issue, is precisely the reason the securities safe harbor was enacted, as demonstrated by the *Seligson* case. When the claim at issue, though, is that the challenged "transfer" was *not* made "to" a protected securities intermediary as "transferee," because the intermediary was a mere conduit who "may not be subject to an avoidance recovery at all," then "a § 546(e) exception is unnecessary."[128]

And that is the more typical claim made in LBO litigation against selling shareholders—that the avoidable "transfers" are the payments "made *by*" the debtor as transferor "*to*" the selling shareholders as "transferees." That this is the "transfer" sought to be avoided (*and* sought to be shielded from avoidance under § 546(e), if applicable) in LBO litigation against selling shareholders is made clear by the doctrine of "collapsing" the transaction structure of an LBO.

Collapsing the Transaction Structure of an LBO as Against Selling Shareholders

As Professor Frost noted in a previous issue of *Bankruptcy Law Letter*, "[o]ften leveraged buyouts are structured in such a way that the strict application of the fraudulent transaction laws cannot reach the transfers made."[129] For example, in the stylized LBO of debtor "D" set forth above, note that the nominal structure of the LBO is one in which *the acquirer* paid the selling shareholders for their D stock, *not* debtor D. It might seem, therefore, that the selling shareholders have no avoidance li-

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ability exposure at all, because "the constructive fraud provision [only] applies to transfers *by* an insolvent *debtor*,"[130] and as structured, a selling shareholder could not be considered the "transferee" of any transfer made "by" debtor D as transferor "to" the selling shareholder. The precise transaction structure the parties employ to effectuate an LBO is not determinative, though, because the courts have developed a doctrine analogous to the step-transaction doctrine of tax law,[131] known as "collapsing" the transaction structure.

" '[C]ollapsing' enables courts to ignore the formal (and often artificial) structure of a transaction or series of transactions."[132] "Courts have 'collapsed' a series of transactions into one transaction when it appears that despite the formal structure and the labels attached, the segments, in reality, comprise a single integrated scheme,"[133] and "[i]t is well established that multilateral transactions may under appropriate circumstances be 'collapsed' and treated as phases of a single transaction for analysis under the" fraudulent transfer statutes.[134] Indeed, "the concept of 'collapsing' a series of transactions and treating them as a single integrated transaction has been applied primarily when analyzing a transfer alleged to be fraudulent in the context of a failed leveraged buy-out."[135] As Professor Markell has noted in this journal, "[p]articularly in the leveraged buyout area, courts have not hesitated to collapse transactions in order to evaluate the substance of a transaction."[136]

In our representative LBO of debtor D, then, a viable fraudulent transfer action against the selling shareholders would be dependent upon collapsing the transaction structure of the LBO as against those selling shareholders. Collapsing would recharacterize the transactions as D borrowing money and selling stock to the acquirer and then using the loan and stock-sale proceeds to repurchase the selling shareholders' stock,[137] such that selling shareholders "are direct transferees of [debtor D]'s property"[138] and thus "liable as . . . transferee[s] in the alleged fraudulent conveyance."[139]

Collapsing Doctrine and a "Transfer" as the Fundamental Transactional Unit

At this point, the astute reader may have already recognized the connection between "collapsing" a series of related transactions and the "mere conduit" doctrine. Whether transactions "should be collapsed and whether a party is a 'mere conduit' are different issues involving different analyses."[140] Nonetheless, they are both directed at the same object: properly conceptualizing the transactional unit for purposes of analyzing the avoidability (or not) of a "transfer" allegedly made "by" the debtor-transferor "to" a "transferee." As Professor Frost perceptively noted, "mere conduit" doctrine "in a sense collapse[s] two [or more] transactions into one,"[141] and a few courts have noted the converse in connection with "collapsing" doctrine—disregarded intermediaries in collapsed transactions are essentially treated as if they were "mere conduits."[142]

"In deciding whether to collapse the transaction and impose liability on particular defendants, the courts have looked frequently to the knowledge of the defendants of the structure of the entire transaction."[143] For example, in the seminal *Wieboldt* decision, the court collapsed the LBO transaction structure as against controlling and insider shareholders who were aware of or participated in the structuring of the LBO. The court refused, however, to collapse the transaction structure as against public shareholders who merely tendered their shares in response to a public tender offer for the debtor's stock.[144] Public shareholders' protection against avoidance liability in connection with an LBO, therefore, is attributable to the courts' general unwillingness to collapse LBO transaction structure in order to impose avoidance liability upon them.[145]

If, however, the LBO transaction structure *is* collapsed as against a selling shareholder (or a collapsing theory is sufficiently alleged for purposes of a motion to dismiss or a summary judgment motion[146]), then the "transfer" at issue was allegedly "made *by*" the debtor as transferor "*to*" the defendant selling shareholder as "transferee." If *neither* the debtor *nor* the selling shareholder is a qualifying § 546(e) intermediary, and thus the "transfer" at issue was *not* "made by or to" a qualifying securities intermediary, then the § 546(e) securities safe harbor, by its express terms, does *not* apply to shield that "transfer" from avoidance. As Judge Gross correctly noted, therefore, "as a general rule, section 546(e) does *not* apply to 'collapsed' transactions,"[147] because generally neither the debtor-transferor nor the shareholder-transferee in such cases is a protected securities intermediary.

Conclusion

The fundamental analytical transaction unit throughout the Code's avoiding-power provisions is the "transfer" sought to be avoided, and the same is true of the § 546(e) securities safe harbor. Thus, that safe harbor is applicable only if (1) the "transfer" at issue (a) was "made by" a debtor-transferor who was a qualifying securities intermediary, "or" (b) was made "to" a "transferee" ("or for the benefit of" a non-transferee) who was a protected securities intermediary, and (2) that "transfer" was a settlement payment or was made in connection with a securities contract.

ENDNOTES:

[1]For example, a recent article *defending* the Bankruptcy Code's various securities and derivatives safe harbors noted, without any counter-argument at all, Professor Mooney's eminently sensible, representative position that the § 546(e) "settlement-payment avoidance protection should not apply to rescue a beneficial investor that has been paid by its issuer from the issuer risk that it necessarily assumed" by investing in the security at issue. Mark D. Sherrill, In Defense of the Bankruptcy Code's Safe Harbors, 70 Bus. Law. 1007, 1023 (2015) (quoting Charles W. Mooney, The Bankruptcy Code's Safe Harbors for Settlement Payments and Securities Contracts: When Is Safe *Too* Safe?, 49 Tex. Int'l L. J. 243, 262 (2014)).

[2]See, e.g., In re Plassein Intern. Corp., 590 F.3d 252, 255, 52 Bankr. Ct. Dec. (CRR) 145, Bankr. L. Rep. (CCH) P 81653 (3d Cir. 2009) (in making payments at issue to shareholders, "the parties did not make use of the 'settlement system'—the system of intermediaries and guarantees usually employed in securities transactions").

[3]See Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V., 651 F.3d 329, 55 Bankr. Ct. Dec. (CRR) 12, 65 Collier Bankr. Cas. 2d (MB) 1833 (2d Cir. 2011); Christopher W. Frost, The Continued Expansion of Section 546(e): Has the Safe Harbor Swallowed the Rule?, 31 Bankr. L. Letter No. 10, at 1 (Oct. 2011).

[4]Judge Gregg, among others, pointed this out in In re Quality Stores, Inc., 355 B.R. 629, 635 n.5, 47 Bankr. Ct. Dec. (CRR) 98 (Bankr. W.D. Mich. 2006), aff'd sub nom., QSI Holdings, Inc. v. Alford, 382 B.R. 731 (W.D. Mich. 2007), judgment aff'd, 571 F.3d 545, 51 Bankr. Ct. Dec. (CRR) 222, Bankr. L. Rep. (CCH) P 81528 (6th Cir. 2009). See also Jewel Recovery, L.P. v. Gordon, 196 B.R. 348, 353 (N.D. Tex. 1996). On the practical reality of parties " 'structur[ing]' their way out of liability under avoiding power statutes" by virtue of prevailing interpretations of § 546(e), see Jonathan M. Landers & Sandra A. Riemer, A New Look at Fraudulent Transfer Liability in High Risk Transactions, Bus. L. Today, Dec. 2016, at 1, 3. See also Joel D. Applebaum, et al., The Ins and Outs of LBOs, American Bankruptcy Institute 20th Annual Central States Bankruptcy Workshop, 061313 ABI-CLE 197 (June 13, 2013) (containing a section entitled "Drafting LBO Documents to Claim the 'Safe Harbor' of Section 546(e) of the Bankruptcy Code" and advising use of a qualifying financial institution as an "exchange agent" for LBO payments to shareholders).

[5]See Plassein, 590 F.3d at 255 (applying § 546(e) to an ordinary wire transfer from debtor's bank "to the shareholders' private accounts at their various banks"), aff'g In re Plassein Intern. Corp., 366 B.R. 318, 323, 48 Bankr. Ct. Dec. (CRR) 62, 28 A.L.R. Fed. 2d 829 (Bankr.

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D. Del. 2007) ("federal regulations require that a wire transfer must be performed by a bank; thus, a wire transfer must be made through a financial institution" of the sort referenced in § 546(e)).

[6]See Mooney, 49 Tex. Int'l L. J. at 265-66. See also Enron, 651 F.3d at 345-47 (Koetl, D.J., dissenting); Frost, 31 Bankr. L. Letter No. 10, at 4-5.

[7]See Christopher W. Frost, Settlement Payments and the Safe Harbor of Section 546(e), 28 Bankr. L. Letter No. 5, at 1 (May 2008); Frost, 31 Bankr. L. Letter No. 10; Andrew Kull, Common-Law Restitution and the Madoff Liquidation, 31 Bankr. L. Letter No. 12, at 2, 9, 12-13 (Dec. 2011).

[8]See In re Bernard L. Madoff Inv. Securities LLC, 773 F.3d 411, 60 Bankr. Ct. Dec. (CRR) 106, 72 Collier Bankr. Cas. 2d (MB) 1295, Bankr. L. Rep. (CCH) P 82737 (2d Cir. 2014), cert. denied, 135 S. Ct. 2858, 192 L. Ed. 2d 910 (2015) and cert. denied, 135 S. Ct. 2859, 192 L. Ed. 2d 910 (2015). See generally Andrew Kull, Common-Law Restitution and the Madoff Liquidation, 92 B.U. L. Rev. 939, 956-58, 962-65 (2012); Samuel P. Rothschild, Note, Bad Guys in Bankruptcy: Excluding Ponzi Schemes From the Stockbroker Safe Harbor, 112 Colum. L. Rev. 1376 (2012).

[9]See Mooney, 49 Tex. Int'l L.J. at 265.

[10]In re Healthco Intern., Inc., 195 B.R. 971, 981-83, 35 Collier Bankr. Cas. 2d (MB) 1345 (Bankr. D. Mass. 1996).

[11]Matter of Munford, Inc., 98 F.3d 604, 609-10, 36 Collier Bankr. Cas. 2d (MB) 1673 (11th Cir. 1996).

[12]Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V., 651 F.3d 329, 338-39, 55 Bankr. Ct. Dec. (CRR) 12, 65 Collier Bankr. Cas. 2d (MB) 1833 (2d Cir. 2011); In re Quebecor World (USA) Inc., 719 F.3d 94, 98, 99-100, 58 Bankr. Ct. Dec. (CRR) 12, 69 Collier Bankr. Cas. 2d (MB) 1253, Bankr. L. Rep. (CCH) P 82505 (2d Cir. 2013).

[13]In re Resorts Intern., Inc., 181 F.3d 505, 515-16, 34 Bankr. Ct. Dec. (CRR) 736, Bankr. L. Rep. (CCH) P 77952 (3d Cir. 1999); In re Plassein Intern. Corp., 590 F.3d 252, 257-58, 52 Bankr. Ct. Dec. (CRR) 145, Bankr. L. Rep. (CCH) P 81653 (3d Cir. 2009).

[14]In re QSI Holdings, Inc., 571 F.3d 545, 550-51, 51 Bankr. Ct. Dec. (CRR) 222, Bankr. L. Rep. (CCH) P 81528 (6th Cir. 2009).

[15]Contemporary Industries Corp. v. Frost, 564 F.3d 981, 986-87, 51 Bankr. Ct. Dec. (CRR) 157, Bankr. L. Rep. (CCH) P 81473 (8th Cir. 2009).

[16]FTI Consulting, Inc. v. Merit Management Group, LP, 830 F.3d 690, 62 Bankr. Ct. Dec. (CRR) 250, 75 Collier Bankr. Cas. 2d (MB) 1855, Bankr. L. Rep. (CCH) P 82972 (7th Cir. 2016), cert. granted, 137 S. Ct. 2092, 197 L. Ed. 2d 894 (2017).

[17]The facts set forth herein are taken from the complaint filed in the adversary proceeding in Valley View's bankruptcy case, the courts' published opinions in that case, and the parties' briefing before the Seventh Circuit.

[18]Brief of Defendant-Appellee at 5, FTI Consulting, Inc. v. Merit Mgmt. Grp., 830 F.3d 690 (7th Cir. 2016) (No. 15-3388), 2016 WL 614281, at *5.

[19]FTI Consulting, Inc. v. Merit Management Group, LP., 541 B.R. 850, 852, Bankr. L. Rep. (CCH) P 82875 (N.D. Ill. 2015), rev'd, 830 F.3d 690, 62 Bankr. Ct. Dec. (CRR) 250, 75 Collier Bankr. Cas. 2d (MB) 1855, Bankr. L. Rep. (CCH) P 82972 (7th Cir. 2016), cert. granted, 137 S. Ct. 2092, 197 L. Ed. 2d 894 (2017) (emphasis added). See also Brief of Defendant-Appellee at 12, FTI Consulting, Inc. v. Merit Mgmt. Grp., 830 F.3d 690 (7th Cir. 2016) (No. 15-3388), 2016 WL 614281, at *12 ("Here, Valley View Downs paid Merit Management, through two financial institutions").

[20]11 U.S.C.A. §§ 544(b)(1) (emphasis added) (giving trustee or DIP powers of individual creditors to avoid transfers under state law, e.g., using state fraudulent transfer statutes), 547(b) (emphasis added) (preferential transfers), 548(a)(1) (emphasis added) (fraudulent transfers). Some of the other avoiding powers alter the operative language slightly, but nonetheless still operate to avoid a "transfer" of property. See, e.g., 11 U.S.C.A. §§ 544(a) (so-called strong-arm power to "avoid any *transfer* of property of the debtor" (emphasis added)); 549(a)(1) (power to "avoid a *transfer* of property of the [bankruptcy] estate that occurs after the commencement of the case" (emphasis added)). The power to avoid statutory liens is phrased in terms of "avoid[ing] the *fixing* of a statutory lien on property of the debtor." 11 U.S.C.A. § 545 (emphasis added). A "lien," though, is defined in Code § 101(37) as "a charge against or interest in property," and a "transfer" is defined in § 101(54)(A) to include "the creation of a lien." The "fixing" of a statu-

tory lien, therefore, is synonymous with "transfer" of a property interest. Indeed, the predecessor bankruptcy statute, the Bankruptcy Act of 1898, explicitly included "fixing a lien upon property or upon an interest therein" within the statute's definition of a "transfer." Bankruptcy Act of 1898 § 1(30), reprinted in 1 Collier on Bankruptcy 44.2 (James Wm. Moore et al. eds., 14th ed. 1974). Thus, Bankruptcy Code § 550(a) and § 551 both refer to a "*transfer* [that] is avoided under section . . . 545." 11 U.S.C.A. §§ 550(a), 551 (emphasis added).

[21]In re Harwell, 628 F.3d 1312, 1317 n.6, 54 Bankr. Ct. Dec. (CRR) 12, 64 Collier Bankr. Cas. 2d (MB) 1820, Bankr. L. Rep. (CCH) P 81909 (11th Cir. 2010).

[22]Cf. Andrea Coles-Bjerre, Bankruptcy Theory and the Acceptance of Ambiguity, 80 Am. Bankr. L.J. 327, 337 (2006). Professor Coles-Bjerre's article explores the intractable ambiguity (or vagueness) regarding whether the fundamental transactional unit of an avoidable "transfer" is divisible for various purposes. Her basic point, though, regarding the intrinsic ambiguity (or vagueness) in determining the "transfer" that is avoidable (from a "whole" versus "part" perspective) also applies to defining the contours of the whole or entire "transfer" itself.

[23]Thus, the courts uniformly recognize that the "Bankruptcy Code does not define [who should be considered the] 'transferee' " of such a "transfer." Harwell, 628 F.3d at 1317. See infra notes 48-56 and accompanying text. And the same is true with respect to the transferor of a "transfer"; i.e.: "by" whom was the transfer "made"? See infra note 57.

[24]See supra note 20 and accompanying text.

[25]Union Bank v. Wolas, 502 U.S. 151, 152, 112 S. Ct. 527, 528, 116 L. Ed. 2d 514, 22 Bankr. Ct. Dec. (CRR) 574, 25 Collier Bankr. Cas. 2d (MB) 1011, Bankr. L. Rep. (CCH) P 74296A (1991) (emphasis added).

[26]BFP v. Resolution Trust Corp., 511 U.S. 531, 535, 114 S. Ct. 1757, 1760, 128 L. Ed. 2d 556, 25 Bankr. Ct. Dec. (CRR) 1051, 30 Collier Bankr. Cas. 2d (MB) 345, Bankr. L. Rep. (CCH) P 75885 (1994) (emphasis added). See also id. at 533 (with respect to that same constructive fraud provision, discussing "the Bankruptcy Code's requirement that *transfers* of property *by* insolvent *debtors* within one year prior to filing of a bankruptcy petition be in exchange for a 'reasonably equivalent value' " (emphasis added)).

[27]11 U.S.C.A. § 548(a)(1)(A) (emphasis added).

[28]11 U.S.C.A. § 548(a)(1)(B)(ii)(IV) (emphasis added).

[29]UFCA §§ 4(a), 5(a), 7A, pt. II U.L.A. 58, 129 (2006); UVTA §§ 4(a), 5(a), 7A, pt. II U.L.A. 20, 29 (Supp. 2017).

[30]See 1898 Act § 60a(1), reprinted in 3, pt. 2 Collier (14th ed.) at 731 (predecessor to Code § 547 preference provision, stating that "[a] preference is a transfer, as defined in this Act, . . . made by [the] debtor" meeting specified criteria); 1898 Act § 67d(2)-(3), reprinted in 4 Collier (14th ed.) at 5-6 (predecessor to Code § 548 fraudulent transfer provision, applicable to "[e]very transfer made . . . by a debtor" meeting specified criteria); 1898 Act § 70e(1), reprinted in 4A Collier (14th ed.) at 5 (predecessor to Code § 544(b)(1), applicable to "[a] transfer made . . . by a debtor" voidable "under any Federal or State law applicable thereto"). The 1898 Act defined "transfer" broadly, in a fashion similar to the Code definition, as "every . . . different mode, direct or indirect, of disposing of or of parting with property or with an interest therein." 1898 Act § 1(30), reprinted in 1 Collier (14th ed.) at 44.2.

[31]Namely, Code "sections 544 [strong-arm and state-law avoidance powers], 545 [avoidable statutory liens], 547 [preferential transfers], 548(a)(1)(B), and 548(b) [constructively fraudulent transfers]." 11 U.S.C.A. § 546(e).

[32]Union Bank v. Wolas, 502 U.S. at 152.

[33]Brief of Defendant-Appellee at 5, FTI Consulting, Inc. v. Merit Mgmt. Grp., 830 F.3d 690 (7th Cir. 2016) (No. 15-3388), 2016 WL 614281, at *5 (emphasis added).

[34]Both the UFTA and UVTA define "transfer" in a fashion nearly identical to that of the Bankruptcy Code, to mean "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset." UFTA § 1(12), 7A, pt. II U.L.A. 15 (2006); UVTA § 1(16), 7A, pt. II U.L.A. 12 (Supp. 2017).

[35]Rupp v. Markgraf, 95 F.3d 936, 942, 29 Bankr. Ct. Dec. (CRR) 834, 36 Collier Bankr. Cas. 2d (MB) 1312 (10th Cir. 1996) (emphasis added).

[36]In re Ogden, 314 F.3d 1190, 1196, 40 Bankr. Ct. Dec. (CRR) 208, Bankr. L. Rep. (CCH) P 78794 (10th Cir. 2002) (emphasis added). See 11 U.S.C.A. § 547(b)(1) (authoriz-

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ing avoidance of a preferential transfer "to a . . . creditor").

[37]"The trustee may not avoid under this section a transfer . . . (2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or (B) according to ordinary business terms." 11 U.S.C.A. § 547(c)(2).

[38]Providing a defense to "a transferee . . . of such a [fraudulent] transfer . . . that takes for value and in good faith . . . to the extent that such transferee . . . gave value to the debtor in exchange for such transfer." 11 U.S.C.A. § 548(c).

[39]124 Cong. Rec. 34,000 (1978) (emphasis added) (statement of Sen. DeConcini); 124 Cong. Rec. 32,400 (1978) (emphasis added) (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).

[40]Christopher W. Frost, Initial Transferee or Mere Conduit: The Seventh Circuit Takes a Stab at a Slippery Concept, 31 Bankr. L. Letter No. 2, at 1 (Feb. 2011).

[41]Charles Jordan Tabb, The Law of Bankruptcy § 6.1, at 464 (3d ed. 2014).

[42]Carson v. Federal Reserve Bank of New York, 254 N.Y. 218, 172 N.E. 475, 70 A.L.R. 435 (1930) (Cardozo, C.J.).

[43]Carson, 172 N.E. at 481-82.

[44]Carson, 172 N.E. at 482.

[45]Indeed, "[b]ankruptcy statutes have always been, by necessity, enacted against and informed by the background of our common law legal system." Ralph Brubaker, Considering the Common Law Origins and Nature of the Code's Avoidance Remedy, 27 Bankr. L. Letter No. 1, at 1, 7 (Jan. 2007). And, of course, "[a] statute will be construed to alter the common law only when that disposition is clear." Antonin Scalia & Bryan A. Garner, Reading Law: The Interpretation of Legal Texts 318 (2012).

As Cardozo insightfully recognized, avoidance and recovery of a transfer invalidated by the Bankruptcy Code unmistakably implicates the common law of restitution and unjust enrichment and a transferee's "duty to make restitution of a preference." Carson, 172 N.E. at 481. "Avoidance as a remedy traces its roots to rescissionary principles of English equity jurisprudence 'which were not essentially different from those' of Roman law." Ralph Brubaker, Lien Avoidance "for the Benefit of the Estate": Textualism, Equitable Powers, and Code Common Law, 26 Bankr. L. Letter No. 1, at 1, 8 (Jan. 2006) (quoting 1 Henry Campbell Black, A Treatise on the Rescission of Contracts and Cancellation of Written Instruments § 2, at 5 (2d ed. 1929)). "Avoidance, then, is an equitable remedy grounded in general restitutionary principles of unjust enrichment." Id. See also Restatement (Third) of Restitution and Unjust Enrichment § 54 cmt. a, at 264 (2011) (explaining that "whenever the basis of the . . . claim is a transfer from the claimant to the defendant that the claimant seeks to undo," this is "a substantive right to avoidance of the transaction in question," alternatively described by "use of the word 'rescission' in describing the right to restitution"). Of course, a bankruptcy trustee (or DIP) seeks to avoid a transfer made by a debtor as representative of the debtor's bankruptcy estate.

[46]Carson, 172 N.E. at 482-83. In other words, a "mere conduit" has no restitution liability "if he has parted before bankruptcy with title and possession" of the property at issue. Id. at 482.

[47]Carson, 172 N.E. at 482.

[48]Bonded Financial Services, Inc. v. European American Bank, 838 F.2d 890, 893, 17 Bankr. Ct. Dec. (CRR) 299, 18 Collier Bankr. Cas. 2d (MB) 155 (7th Cir. 1988).

[49]Bonded Fin., 838 F.2d at 893-94.

[50]Jessica D. Gabel & Paul R. Hage, Who Is a 'Transferee' Under Section 550(a) of the Bankruptcy Code?: The Divide Over Dominion, Control, and Good Faith in Applying the Mere Conduit Defense, 21 Norton J. Bankr. L. & Prac. No. 1, at 47, 51 (Feb. 2012).

[51]In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey, 130 F.3d 52, 56, 31 Bankr. Ct. Dec. (CRR) 978, 38 Collier Bankr. Cas. 2d (MB) 1851, Bankr. L.

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Rep. (CCH) P 77560 (2d Cir. 1997).

[52]Ogden, 314 F.3d at 1202.

[53]Finley Kumble, 130 F.3d at 57, 56.

[54]In re Southeast Hotel Properties Ltd. Partnership, 99 F.3d 151, 155, 29 Bankr. Ct. Dec. (CRR) 1202, 36 Collier Bankr. Cas. 2d (MB) 1649, Bankr. L. Rep. (CCH) P 77158 (4th Cir. 1996).

[55]Frost, 31 Bankr. L. Letter No. 2, at 4.

[56]Gabel & Hage, 21 J. Bankr. L. & Prac. No. 1 at 49.

[57]The "mere conduit" principle can also be implicated in determining whether the transfer at issue was made "by" the debtor as transferor, as required by the Code's avoiding-power provisions. See, e.g., In re Computrex, Inc., 403 F.3d 807, 810-11, 44 Bankr. Ct. Dec. (CRR) 155, Bankr. L. Rep. (CCH) P 80266, 2005 FED App. 0177P (6th Cir. 2005) (no preferential transfer by the debtor because debtor was "a mere disbursing agent"); In re Chase & Sanborn Corp., 813 F.2d 1177, 1178, Bankr. L. Rep. (CCH) P 71753 (11th Cir. 1987) (no fraudulent transfer by the debtor because "the debtor corporation was a mere conduit"). For an extended critique of some courts' test for a "mere conduit" in this context, see Ralph Brubaker, When Property Becomes a Promise Becomes a Preference, 25 Bankr. L. Letter No. 8, at 1 (Aug. 2005). See also In re LGI Energy Solutions, Inc., 460 B.R. 720, 55 Bankr. Ct. Dec. (CRR) 235, 66 Collier Bankr. Cas. 2d (MB) 1329 (B.A.P. 8th Cir. 2011) (declining to follow the *Computrex* decision). Thus, the indeterminacy that motivated enactment of § 546(e) in 1982 (see infra) also prevails in determining "by" whom a challenged "transfer" was "made." Indeed, in 1987 the *Chase & Sanborn* court remarked that "[n]o court, as far as we have discovered, previously has established a framework for determining when funds provided to a debtor by a third party become property of the debtor so that an allegedly fraudulent transfer of the funds . . . is subject to avoidance" as a transfer "made by" the debtor. Chase & Sanborn, 813 F.2d at 1180.

[58]11 U.S.C.A. § 547(b)(1) (emphasis added). The predecessor provision in the 1898 Act also provided that "a transfer . . . made by [the] debtor" could be avoided if made "to *or for the benefit of* a creditor" preferred thereby. 1898 Act § 60a(1) (emphasis added), reprinted in 3, pt. 2 Collier (14th ed.) at 731.

[59]11 U.S.C.A. § 548(a)(1) (emphasis added).

[60]11 U.S.C.A. § 550(a)(1) (emphasis added).

[61]Carson, 172 N.E. at 482.

[62]In re Meredith, 527 F.3d 372, 375, 50 Bankr. Ct. Dec. (CRR) 45, 59 Collier Bankr. Cas. 2d (MB) 1382, Bankr. L. Rep. (CCH) P 81252 (4th Cir. 2008) (emphasis added) (citations omitted) (quoting In re Columbia Data Products, Inc., 892 F.2d 26, 49, 19 Bankr. Ct. Dec. (CRR) 1799, Bankr. L. Rep. (CCH) P 73106 (4th Cir. 1989) (quoting Bonded Fin., 838 F.2d at 895)).

[63]Bonded Fin., 838 F.2d at 896.

[64]And neither Valley View nor Merit Management contends that the challenged "transfer" was made "for the benefit of" Credit Suisse or Citizens Bank.

[65]"A word or phrase is presumed to bear the same meaning throughout a text." Scalia & Garner, Reading Law at 170.

[66]"Perhaps no interpretive fault is more common than the failure to follow the whole-text canon, which calls on the judicial interpreter to consider the entire text, in view of its structure and of the physical and logical relation of its many parts." Scalia & Garner, Reading Law at 167. "Context is a primary determinant of meaning. A legal instrument typically contains many interrelated parts that make up the whole. The entirety of the document thus provides the context for each of its parts." Id.

[67]The "to (or for the benefit of)" language of § 546(e), not coincidentally, replicates the "to or for the benefit of" language of § 547(b)(1) and the repeated use of that language throughout § 548(a)(1).

[68]See Brief of Defendant-Appellee at 5, FTI Consulting, Inc. v. Merit Mgmt. Grp., 830 F.3d 690 (7th Cir. 2016) (No. 15-3388), 2016 WL 614281, at *5 ("Trustee filed suit against Merit Management . . . seeking avoidance and recovery of transfers Valley View Downs made to Merit Management in the amount of $16,503,850.").

[69]And neither Valley View nor Merit Management contends that the challenged "transfer" was made "for the benefit of" Credit Suisse or Citizens Bank.

[70]Bonded Fin., 838 F.2d at 893.

[71]Scalia & Garner, Reading Law at 126.

[72]RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 132 S. Ct. 2065,

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2071, 182 L. Ed. 2d 967, 56 Bankr. Ct. Dec. (CRR) 144, 67 Collier Bankr. Cas. 2d (MB) 483, Bankr. L. Rep. (CCH) P 82218 (2012).

[73]Those courts apparently did not even realize that their construction of the determinative language of § 546(e) is at odds with its accepted meaning throughout the rest of the Code's avoidance provisions. See infra notes 75-78 and accompanying text.

[74]"The imperative of harmony among provisions is more categorical than most other canons of construction because it is invariably true that intelligent drafters do not contradict themselves (in the absence of duress)." Scalia & Garner, Reading Law at 180.

[75]Quebecor World, 719 F.3d at 96, 99 (emphasis added). See also In re Quebecor World (USA) Inc., 453 B.R. 201, 204, 212, 55 Bankr. Ct. Dec. (CRR) 60 (Bankr. S.D. N.Y. 2011) ("It is undisputed that these substantial payments were *made by [debtor]* QWUSA *to* the Noteholders . . . within the ninety day period" before bankruptcy, as required by Code § 547(b), which "provides that the trustee of a bankruptcy estate may recover . . . money or property *transferred by an insolvent debtor* in the ninety days preceding bankruptcy, where the *transfer* (1) was *made to* . . . a creditor." (emphasis added)), aff'd, 480 B.R. 468, Bankr. L. Rep. (CCH) P 82355 (S.D. N.Y. 2012), judgment aff'd, 719 F.3d 94, 58 Bankr. Ct. Dec. (CRR) 12, 69 Collier Bankr. Cas. 2d (MB) 1253, Bankr. L. Rep. (CCH) P 82505 (2d Cir. 2013).

Although it is unclear, given the procedural posture of the case, some of the defendants in *Quebecor World* may have been financial institutions. If so, and if the challenged payments were "settlement payments" or transfers in connection with a "securities contract," which the Second Circuit held to be the case, then the debtor's alleged transfers "to" those defendants who were financial institutions would be shielded from avoidance under the terms of § 546(e).

[76]Quebecor World, 719 F.3d at 99 (emphasis added). The bankruptcy court made a similar (conclusory and self-contradictory) assertion: "In determining that *the transfer in question* [see supra note 75] qualifies for the [§ 546(e)] exemption, the Court must find that [it] has been *made to* a 'financial institution.' . . . [W]ithout question the Disputed Transfer was 'made . . . to . . . a . . . financial institution,' *i.e.*, CIBC Mellon as trustee for the Notes." Quebecor World, 453 B.R. at 212 (emphasis added).

[77]Quebecor World, 719 F.3d at 99.

[78]In *Resorts International*, the Third Circuit described the "transfer" sought to be avoided as debtor "Resorts' payment to [shareholder] Lowenschuss." 181 F.3d at 514 (stating that "section 548 would allow the trustee to avoid *the transfer*" if debtor "Resorts received less than a reasonably equivalent value to the $3,800,000 *it [debtor Resorts] paid*" as "the transfer to Lowenschuss" (emphasis added)). But for purposes of its application of the § 546(e) safe harbor, the court (incongruously) stated that the "transfer" at issue was "made by . . . a financial institution" because "Resorts wired [the] funds to Chase which Chase then forwarded to Merrill Lynch who paid Loweschuss," and Merrill Lynch and Chase were financial institutions. Id. at 515. See also QSI Holdings, 571 F.3d at 547, 551, 548 (acknowledging that "transfer" debtors "seek to avoid [is] payments [they] made *to* approximately 170 shareholders," but also stating (inconsistently) "that the transfer was made *to* a financial institution" because the debtors made those payments through HSBC Bank as "exchange agent" (emphasis added)).

[79]Zahn v. Yucaipa Capital Fund, 218 B.R. 656, 676-77 n.31 (D.R.I. 1998). One of the functions of the surplusage canon is to prevent "an interpretation [of a provision] that renders it pointless." Scalia & Garner, Reading Law at 176.

[80]"Associated words bear on one another's meaning (*noscitur a sociis*)." Scalia & Garner, Reading Law at 195.

[81]Kaiser Steel Corp. v. Charles Schwab & Co., Inc., 913 F.2d 846, 849 n.4, 20 Bankr. Ct. Dec. (CRR) 1650, 23 Collier Bankr. Cas. 2d (MB) 1403, Bankr. L. Rep. (CCH) P 73620 (10th Cir. 1990). See S. Rep. No. 95-989, at 106 (1978) (citing Seligson v. New York Produce Exchange, 394 F. Supp. 125 (S.D. N.Y. 1975)), reprinted in 1978 U.S.C.C.A.N. 5787, 5892.

[82]Seligson, 394 F. Supp. at 127-28 (emphasis added). Avoidability as a constructively fraudulent transfer also turned on "whether the [debtor] transferor received 'fair consideration' for the transfer." Id. at 127. Congress also enacted a corresponding safe harbor for this "value" issue in 1978 in the original version of Code § 548(d)(2)(B). See Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 2600-01.

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[83]Seligson, 394 F. Supp. at 135.

[84]Bonded Fin., 838 F.2d at 893.

[85]Pub. L. No. 95-598, 92 Stat. at 2619 (enacting 11 U.S.C.A. § 764(c)) (superseded in 1982 by 11 U.S.C.A. § 546(e)).

[86]S. Rep. No. 95-989, at 106, reprinted in 1978 U.S.C.C.A.N. at 5892.

[87]Frederick L. White, The Commodity-Related Provisions of the Bankruptcy Act of 1978, 34 Rec. Ass'n B. City N.Y. 262, 269 (1979). The Senate Report, likewise, identified an additional "basic objective" of the commodity broker subchapter "as the protection of commodity market stability." S. Rep. No. 95-989, at 7-8, reprinted in 1978 U.S.C.C.A.N. at 5793-94.

[88]Zahn, 218 B.R. at 676-77 n.31.

[89]"The original reference in section 103(d) to 'section 746(c)' was a typographical error; the reference should have been to 'section 764(c).' " H.R. Rep. No. 97-420, at 3 (1982), reprinted in 1982 U.S.C.C.A.N. 583, 585.

[90]Pub. L. No. 95-598, 92 Stat. at 2555 (emphasis added) (enacting 11 U.S.C.A. § 103(d)) (amended in 1982, with the enactment of 11 U.S.C.A. § 546(e), to repeal the "except" clause).

[91]Union Bank v.Wolas, 502 U.S. at 152.

[92]White, 34 Rec. Ass'n B. City N.Y. at 275 n.13.

[93]Pub. L. No. 95-598, 92 Stat. at 2555 (emphasis added) (enacting 11 U.S.C.A. § 103(d)) (amended in 1982, with the enactment of 11 U.S.C.A. § 546(e), to repeal the "except" clause). See 124 Cong. Rec. 34,018 (1978) (statement of Sen. DeConcini and Sen. Mathias) ("the intent of section 764 . . . is to provide that margin payments . . . previously *made by a bankrupt* to a commodity broker [or] forward contract merchant . . . are non-avoidable transfers by the bankrupt's trustee" (emphasis added)).

[94]See Pub. L. No. 97-222, § 2, 96 Stat. 235, 235 (1982) (repealing the "except" clause of Code § 103(d)).

[95]Pub. L. No. 97-222, § 4, 96 Stat. at 236 (enacting Code § 546(d)); id. § 17(c), 96 Stat. at 240 (repealing Code § 764(c)).

[96]Pub. L. No. 97-222, § 4, 96 Stat. at 236 (enacting Code § 546(d)).

[97]H.R. Rep. No. 97-420, at 1, reprinted in 1982 U.S.C.C.A.N. at 583.

[98]Id. (emphasis added) (citation omitted).

[99]Id. at 2 (emphasis added), reprinted in 1982 U.S.C.C.A.N. at 583.

[100]Pub. L. No. 109-390, § 5(b)(1)(A), 120 Stat. 2692, 2697 (2006) (amending § 546(e)).

[101]The House Report accompanying enactment of what is now § 546(e) explained that the safe harbor was necessary "[b]ecause of the structure of the clearing systems in" the "commodities and securities markets [which] operate through a complex system of accounts and guarantees." H.R. Rep. No. 97-420, at 1, reprinted in 1982 U.S.C.C.A.N. at 583. For explanations of the securities settlement and clearing process, see Irina Fox, Settlement Payment Exception to Avoidance Powers in Bankruptcy, 84 Am. Bankr. L.J. 571, 583-86 (2010); Samir D. Parikh, Saving Fraudulent Transfer Law, 86 Am. Bankr. L.J. 305, 327-31 (2012); Neil M. Garfinkel, Note, No Way Out: Section 546(e) Is No Escape for the Public Shareholder of a Failed LBO, 1991 Colum. Bus. L. Rev. 51, 63-65.

[102]See generally Charles J. Tabb & Ralph Brubaker, Teacher's Manual for Bankruptcy Law: Principles, Policies, and Practice 504-06 (4th ed. 2015) (discussing such a case in a different context); Charles J. Tabb & Ralph Brubaker, Bankruptcy Law: Principles, Policies, and Practice 464-67 (4th ed. 2015); In re Railworks Corp., 2012 WL 6681894 (Bankr. D. Md. 2012), vacated, 2013 WL 3427897 (D. Md. 2013), decision rev'd, 760 F.3d 398, 59 Bankr. Ct. Dec. (CRR) 225, Bankr. L. Rep. (CCH) P 82670 (4th Cir. 2014).

[103]See 11 U.S.C.A. §§ 547(b)(1), 548(a)(1).

[104]See 11 U.S.C.A. § 926(b) (enacted in 1988).

[105]See Scalia & Garner, Reading Law at 195-98.

[106]Quebecor World, 719 F.3d at 99-100 n.3 (emphasis added).

[107]Lowenschuss, 181 F.3d at 516.

[108]Contemporary Indus., 564 F.3d at 987.

[109]Munford, 98 F.3d at 610 (emphasis in original).

[110]Munford, 98 F.3d at 610.

[111]Bonded Fin., 838 F.2d at 893.

[112]See generally Frost, 31 Bankr. L. Letter No. 2, at 4; Gabel & Hage, 21 J. Bankr. L. & Prac. No. 1 at 47.

[113]H.R. Rep. No. 109-648 (pt. I), at 8 (2006),

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reprinted in 2006 U.S.C.C.A.N. 1585, 1593. See Parikh, 86 Am. Bankr. L.J. at 336 n.174. The Second Circuit, therefore, was incorrect when it stated, in the course of its speculative hypothesizing, that "the legislative history does not mention, let alone explain the reasoning behind, this change." Quebecor World, 719 F.3d at 100 n.3.

[114]Tabb, The Law of Bankruptcy, § 6.39, at 598.

[115]Jonathan C. Lipson & Jennifer L. Vandermeuse, Stern, Seriously: The Article I Judicial Power, Fraudulent Transfers, and Leveraged Buyouts, 2013 Wis. L. Rev. 1161, 1220. See generally Tabb & Brubaker, Teacher's Manual at 542-47; Tabb & Brubaker, Bankruptcy Law at 512-13.

[116]Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 980, 197 L. Ed. 2d 398, 63 Bankr. Ct. Dec. (CRR) 242, 77 Collier Bankr. Cas. 2d (MB) 596, 41 I.E.R. Cas. (BNA) 1613, Bankr. L. Rep. (CCH) P 83082 (2017).

[117]Lipson & Vandermeuse, 2013 Wis. L. Rev. at 1221.

[118]See Tabb & Brubaker, Teacher's Manual at 544.

[119]Kaiser Steel Corp. v. Charles Schwab & Co., Inc., 913 F.2d 846, 20 Bankr. Ct. Dec. (CRR) 1650, 23 Collier Bankr. Cas. 2d (MB) 1403, Bankr. L. Rep. (CCH) P 73620 (10th Cir. 1990).

[120]See In re Kaiser Steel Corp., 105 B.R. 639, 644-50, 21 Collier Bankr. Cas. 2d (MB) 1203, Bankr. L. Rep. (CCH) P 73072 (Bankr. D. Colo. 1989), rev'd, 110 B.R. 514, 519-21 (D. Colo. 1990), judgment aff'd, 913 F.2d 846, 20 Bankr. Ct. Dec. (CRR) 1650, 23 Collier Bankr. Cas. 2d (MB) 1403, Bankr. L. Rep. (CCH) P 73620 (10th Cir. 1990).

[121]Kaiser Steel, 105 B.R. at 642.

[122]Kaiser Steel, 105 B.R. at 653.

[123]Kaiser Steel, 105 B.R. at 642.

[124]Kaiser Steel, 105 B.R. at 642.

[125]Kaiser Steel, 105 B.R. at 653.

[126]Kaiser Steel, 110 B.R. at 521.

[127]Kaiser Steel, 110 B.R. at 516 (emphasis added). See Kaiser Steel, 913 F.3d at 848.

[128]Zahn, 218 B.R. 676-77 n.31.

[129]Christopher W. Frost, Inter-Corporate Obligations, Reasonably Equivalent Value, and Beneficiary Liability: *In re TOUSA, Inc.*, 32 Bankr. L. Letter No. 9, at 1, 7 (Sept. 2012).

[130]BFP, 511 U.S. at 1760.

[131]"The step transaction doctrine is a judicially-created doctrine that has traditionally been applied in the tax context. Nevertheless, courts often apply the step transaction concept in other fields as well, including disputes involving issues of . . . fraudulent conveyances." In re Big V Holding Corp., 267 B.R. 71, 92 (Bankr. D. Del. 2001). See Tabb & Brubaker, Teacher's Manual at 545-47 & n.21; Michael J. Heyman, The Step-Transaction Defense: Collapsing Multi-Step Transactions to Defend Against Fraudulent Conveyance Allegations, 30 Cal. Bankr. J. 1 (2009); Peter Spero, Fraudulent Transfers, Prebankruptcy Planning and Exemptions § 1:5 (2017). The step-transaction "doctrine treats the 'steps' in a series of formally separate but related transactions involving the transfer of property as a single transaction, if all steps are substantially linked." Greene v. U.S., 13 F.3d 577, 583, 94-1 U.S. Tax Cas. (CCH) P 50022, 73 A.F.T.R.2d 94-746 (2d Cir. 1994). See Gregory v. Helvering, 1935-1 C.B. 193, 293 U.S. 465, 470, 55 S. Ct. 266, 79 L. Ed. 596, 35-1 U.S. Tax Cas. (CCH) P 9043, 14 A.F.T.R. (P-H) P 1191, 97 A.L.R. 1355 (1935) (refusing to "exalt artifice above reality").

[132]Appleaum, et al., 061313 ABI-CLE 197.

[133]In re Sunbeam Corp., 284 B.R. 355, 370, 40 Bankr. Ct. Dec. (CRR) 101 (Bankr. S.D. N.Y. 2002).

[134]HBE Leasing Corp. v. Frank, 48 F.3d 623, 635, 31 Fed. R. Serv. 3d 1422 (2d Cir. 1995). See also Orr v. Kinderhill Corp., 991 F.2d 31, 35 (2d Cir. 1993) (quoting Pepper v. Litton, 308 U.S. 295, 305, 60 S. Ct. 238, 84 L. Ed. 281 (1939) ("substance will not give way to form" and "technical considerations will not prevent substantial justice from being done)).

[135]Sunbeam, 284 B.R. at 370.

[136]Bruce A. Markell, Substance Over Form in Fraudulent Transfer Law, 34 Bankr. L. Letter No. 2, at 2, 6 (Feb. 2014).

[137]See Tabb & Brubaker, Bankruptcy Law at 545-46.

[138]Wieboldt Stores, Inc. v. Schottenstein, 94 B.R. 488, 503, 18 Bankr. Ct. Dec. (CRR) 1134, 20 Collier Bankr. Cas. 2d (MB) 776, Bankr. L. Rep. (CCH) P 72574A, Fed. Sec. L. Rep. (CCH) P 94872 (N.D. Ill. 1988), on reconsideration in part, 1989 WL 18112 (N.D. Ill. 1989).

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[139]In re Mervyn's Holdings, LLC, 426 B.R. 488, 497-98 (Bankr. D. Del. 2010).

[140]In re Allou Distributors, Inc., 379 B.R. 5, 24, 49 Bankr. Ct. Dec. (CRR) 29 (Bankr. E.D. N.Y. 2007).

[141]Frost, 31 Bankr. L. Letter No. 2, at 5. "In the normal case, the payment of funds to the conduit and the payment of funds to the ultimate transferee—two separate transactions—are treated as a direct payment from the debtor to the ultimate transferee." Id.

[142]See In re TOUSA, Inc., 680 F.3d 1298, 1314-15, 56 Bankr. Ct. Dec. (CRR) 135, 67 Collier Bankr. Cas. 2d (MB) 1035, Bankr. L. Rep. (CCH) P 82276 (11th Cir. 2012); Wieboldt, 94 B.R. at 500, 503.

[143]In re Best Products Co., Inc., 168 B.R. 35, 56-57 (Bankr. S.D. N.Y. 1994). See also Lippi v. City Bank, 955 F.2d 599, 611-14 (9th Cir. 1992).

[144]See Wieboldt, 94 B.R. at 500-04.

[145]See Tabb & Brubaker, Teacher's Manual at 545.

[146]See Allou Distribs., 379 B.R. at 23 (court must consider "the 'collapsing' theory advanced by the Trustee" in order "to determine whether a fraudulent transfer claim has been pleaded or proved").

[147]Mervyn's Holdings, 426 B.R. at 500 (emphasis added).

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