AMERICAN BANKRUPTCY INSTITUTE

Bankruptcy 2024:
Views from the Bench

Supreme Court Round-Up

Rosa J. Evergreen, Co-Moderator
Arnold & Porter Kaye Scholer LLP | Washington, D.C.

Hon. Craig T. Goldblatt, Co-Moderator
U.S. Bankruptcy Court (D. Del.) | Wilmington

Hon. John T. Gregg
U.S. Bankruptcy Court (W.D. Mich.) | Grand Rapids

Hon. Patricia M. Mayer
U.S. Bankruptcy Court (E.D. Pa.) | Reading

Bill Rochelle
American Bankruptcy Institute | Alexandria, Va.

2024

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Panelists and Moderator

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Bill Rochelle

American Bankruptcy Institute, Alexandria, VA

Rosa J. Evergreen

Arnold & Porter, Washington DC

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2024 Supreme Court Case Highlights

The following highlights some of the key cases before the Supreme Court over the past term and pulls a short summary from some of the materials in *Rochelle's Daily Wire* published by the American Bankruptcy Institute, with certain Supreme Court case summaries from *Rochelle's Daily Wire* attached to these materials. These attached summaries provide additional analysis on these and other Supreme Court cases.

1. ***Harrington v. Purdue Pharma L.P.***, 23-124 (Sup. Ct. June 27, 2024). Reversing on nondebtor third-party, nonconsensual releases. Holding that "the bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of affected claimants," Justice Gorsuch reversed and remanded.

   Some questions/ musings following Purdue:

   - What are the implications of the decision for bankruptcy law?
   - Where does this leave non-consensual releases?
   - What is the impact on consensual releases, if any?
   - What constitutes consent?
   - What is the impact of the decision on exculpation provisions in plans?
   - What is the impact on cases post-Purdue that were in early confirmation status when the decision came out – *e.g.,* have been confirmed, but not effective yet, or confirmed but not substantially consummated, if any?
   - What are the practical implications?

2. ***SEC v. Jarkesy***, 144 S. Ct. 2118 (2024). This was a non-bankruptcy decision but provides a lot of issues for consideration in the bankruptcy context. The decision holds that the SEC may not impose, via agency administrative enforcement, civil monetary penalties on an investment advisor for violations of the federal securities laws. The Supreme Court held that the statutory scheme that permitted the agency to award civil monetary penalties violated the Seventh Amendment's right to a jury trial. *Musings from Judge Goldblatt* on this case follow in the next section.

3. ***Office of the U.S. Trustee v. John Q. Hammons Fall 2006 LLC***, 22-1238 (Sup. Ct. June 14, 2024). Differing with all four circuits that had held to the contrary, the Supreme Court ruled in a 6/3 decision that chapter 11 debtors in 48 states who paid $326 million in unconstitutionally higher U.S. Trustee fees are not entitled to refunds.

   The Supreme Court decided two years ago that the 2018 increase in U.S. Trustee fees paid by chapter 11 debtors was unconstitutional because it was not immediately applicable in the two states with Bankruptcy Administrators rather than U.S. Trustees. *Siegel v. Fitzgerald*, 142 S. Ct. 1770 (Sup. Ct. June 6, 2022). *Siegel* explicitly left open the question of whether debtors who had paid too much were entitled to refunds. Justice Ketanji Brown Jackson wrote the opinion of the Court nixing the idea of refunds. The

majority held that "prospective parity" was a sufficient remedy, because Congress had amended the statute in 2020 to ensure that fees would always be uniform in the future.

4. ***Truck Ins. Exch. v. Kaiser Gypsum Co***., 22-1079 (Sup. Ct. June 6, 2024). Reversing the Fourth Circuit, the Supreme Court held that an "insurance neutral" chapter 11 plan does not deprive the insurer of standing to raise objections to the plan. For a unanimous Court, Justice Sonia Sotomayor said, "Courts must determine on a case-by-case basis whether a prospective party has a sufficient stake in reorganization proceedings to be a 'party in interest'" under Section 1109(b).

5. ***Bissonnette v. LePage Bakeries Park St. LLC*****,** 23-51 (Sup. Ct. April 1, 2024). This is a non-bankruptcy case. Justice Roberts surveyed the Supreme Court's more recent authorities on arbitration, noting how the Court had ruled in 2001 that the exception in Section 1 "is limited to transportation workers." *Circuit City Stores Inc. v. Adams*, 532 U.S. 105 (2001).

   The Court said that the exception applies to workers who are "engaged" in commerce and does not turn on the industry of the employer. The relevant question, Justice Roberts said, asks what the employee does for the employer, not what the employer does. Thus, he said, "A transportation worker need not work in the transportation industry to fall within the exemption from the FAA provided by § 1 of the Act." The Chief Justice ruled that the Second Circuit "erred in compelling arbitration on the basis that petitioners work in the bakery industry." The Court vacated the judgment of the Second Circuit and remanded for further proceedings, expressing "no opinion on any alternative grounds in favor of arbitration raised below, including that petitioners are not transportation workers . . . ."

6. ***F.B.I v. Fikre*****, 22-1178** (Sup. Ct. March 19, 2024). On March 19, the Court handed down a non-bankruptcy decision on constitutional mootness. Affirming the Circuit Court, Justice Gorsuch decided that the case was not moot because the government's statement only referred to reliance on actions taken in the past. "[N]one of that," he said, "speaks to whether the government might relist him if he does the same or similar things in the future."

   Notably one thing this case says nothing about, however, is the validity of the doctrine of equitable mootness. This is an area that the Supreme Court has been ducking in bankruptcy…

7. ***NexPoint Advisors, L.P. v. Highland Cap. Mgmt., L.P****. (In re Highland Cap. Mgmt., L.P.)*, 48 F.4th 419 (5th Cir. 2022) (Duncan, J.), *petitions for cert. filed*, No. 22-631 (U.S. Jan. 9, 2023), No. 22-669 (U.S. Jan. 20, 2023): This petition was denied after the Court decided Purdue.

   The question presented in the petition: (1) Whether a bankruptcy court may exculpate third party misconduct that falls short of gross negligence, on the theory that

bankruptcy trustees have common-law immunity for such misconduct and (2) whether a bankruptcy court may exculpate parties from ordinary post-bankruptcy business liabilities. The petitions were initially distributed for conference on March 24, 2023 (Highland) and on May 11, 2023 (NexPoint).

On May 15, 2023, the Solicitor General was invited to file a brief expressing the views of the United States. The petitions were distributed again for conference on December 8, 2023, and remained pending for over a year. The petition was denied on July 02, 2024; right after *Purdue* was decided.

Next Term: *U.S. v. Miller*, 23-824 (Sup. Ct.) (cert granted).

To resolve a split of circuits, the Supreme Court has granted certiorari to decide whether the waiver of sovereign immunity in Section 106(a) permits a bankruptcy trustee to sue the federal government for receipt of a fraudulent transfer under Section 544(b)(1), when an actual creditor could not sue the government outside of bankruptcy.

Questions presented:

> The Bankruptcy Code permits a bankruptcy trustee to avoid any prepetition transfer of the debtor's property that would be voidable "under applicable law" outside bankruptcy by an actual unsecured creditor of the estate. 11 U.S.C. 544(b)(1). The applicable law may be state law. Elsewhere, the Code abrogates the sovereign immunity of all governmental units "to the extent set forth in this section with respect to" various sections of the Code, including Section 544. 11 U.S.C. 106(a)(l). The court of appeals below joined a circuit split in holding that Section 106(a)(l) permits a bankruptcy trustee to avoid a debtor's tax payment to the United States under Section 544(b), even though no actual creditor could have obtained relief outside of bankruptcy in light of sovereign immunity, the Supremacy Clause, and the Appropriations Clause.
>
> The question presented is as follows: Whether a bankruptcy trustee may avoid a debtor's tax payment to the United States under Section 544(b) when no actual creditor could have obtained relief under the applicable state fraudulent-transfer law outside of bankruptcy.

The petition was granted on June 24, 2024. Oral argument has not yet been set.

Musings by Judge Goldblatt on *SEC v. Jarkesy*

The Supreme Court's recent decision in *SEC v. Jarkesy*, 144 S. Ct. 2118 (2024), holds that the SEC may not impose, via agency administrative enforcement, civil monetary penalties on an investment advisor for violations of the federal securities laws. The Supreme Court held that the statutory scheme that permitted the agency to award civil monetary penalties violated the Seventh Amendment's right to a jury trial.

The text of the Seventh Amendment provides that in "[s]uits at common law, ... the right of trial by jury shall be preserved." The *Jarkesy* Court explained that this guarantee extends to any claim this is "legal in nature" regardless of whether the claim is created by statute or common law. 144 S. Ct. at 2128-2129. And to determine whether a claim is legal, the principal focus is on the remedy provided.

The Court explained that:

> While monetary relief can be legal or equitable, money damages are the prototypical common law remedy. What determines whether a monetary remedy is legal is if it is designed to punish or deter the wrongdoer, or, on the other hand, solely to restore the status quo…. [A] civil sanction that cannot fairly be said solely to serve a remedial purpose, but rather can only be explained as also serving either retributive or deterrent purposes, is punishment. And while courts of equity could order a defendant to return unjustly obtained funds, only courts of law issued monetary penalties to punish culpable individuals. Applying these principles, we have recognized that civil penalties are a type of remedy at common law that could only be enforced in courts of law. The same is true here.

Id. at 21229 (citations, internal quotations and brackets omitted).

The Court then went on to address whether the claim was subject to the "public rights" exception to the Seventh Amendment. The Court noted that it had first recognized such an exception to the Seventh Amendment in *Murray's Lessee*, 59 U.S. 272 (1855). There, the Court authorized "summary proceedings" to collect customs taxes owed to the federal government. Other "historic categories of adjudication" also fall within the public rights exception, including relations with Indian land, the administration of public land, and the granting of public benefits. *Jarkesy*, 144 S.Ct. at 2133.

The Court observed that its decision in *Ganfinciera, S.A. v. Nordberg*, 492 U.S. 33 (1989), also involved an act of Congress that authorized a non-Article III court to adjudicate a clam for fraud without a jury trial. There, the question was whether a defendant in a fraudulent conveyance case had a constitutional right to a jury trial. There, the Court held that the fraudulent conveyance cause of action codified in the Bankruptcy Code was akin to the kind of action "brought at law in late 18th century England." *Granfinanciera*, 492 U.S. at 43. As such, it did not fit within the "public rights" exception to the Seventh Amendment.

Jarkesy's explanation of how the *Granfinanciera* Court understood the relationship between fraudulent conveyance actions and the rest of bankruptcy law may well be critical to *Jarkesy*'s impact on bankruptcy. "We also considered whether these actions were closely intertwined with the bankruptcy regime. Some bankruptcy claims, such as creditors' hierarchically ordered claims to a pro rata share of the bankruptcy res, are highly interdependent and require coordination. Resolving such claims fairly is only possible if they are all submitted at once to a single adjudicator." *Jarkesy*, 144 S. Ct. 2135 (quotations and internal citations omitted). "Otherwise, parties with lower priority claims can rush to the courthouse to seek payment before higher priority claims exhaust the estate, and an orderly disposition of a bankruptcy is impossible. Other claims, though, can be brought in standalone suits, because they are neither prioritized nor subordinated to related claims. Since fraudulent conveyance actions fall into that latter category, we concluded that these actions were not closely intertwined with the bankruptcy process." *Id.* (internal quotations and citations omitted).

The Court went on to say that the rationale of *Granfinanciera* was controlling. The only relevant distinction between the fraudulent conveyance action and the SEC enforcement proceeding was the fact that the Government was a party to the agency enforcement action. But relying on *Marathon Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), the Court observed that it had never found "the presence of the United States as a proper party to the proceeding" to be sufficient to trigger the public rights exception to the Seventh Amendment. *Jarkesy*, 144 S. Ct. at 2136.

What are the implications of the decision for bankruptcy law? The answers to that question are less than crystal clear. But here are a few observations about the implication of the decision for particular types of bankruptcy proceedings:

- **Fraudulent conveyance actions.** After *Stern v. Marshall*, 464 U.S. 462 (2011), many bankruptcy courts had concluded that fraudulent conveyance claims, like the counterclaim to the proof of claim at issue in *Stern*, needed to be treated as "*Stern* matters" – meaning claims that may be designated as "core matters" under 28 U.S.C. § 157(b), but that cannot consistent with Article III and the Seventh Amendment be so treated. While some bankruptcy courts have resisted this conclusion, *Jarkesy*'s treatment of the *Granfinanciera* precedent ought to resolve any lingering doubt on that issue. Fraudulent conveyance actions fall outside the "public rights" exception to the Seventh Amendment. Accordingly, a party to such a case (except one who files a proof of claim or consents to adjudication by a bankruptcy court) is entitled to a jury trial and to have any "final judgment" entered by an Article III tribunal.

- **Claims allowance.** *Jarkesy*'s description of *Granfinanciera* seems to reinforce the proposition that the claims allowance process may properly be treated as "core." The Court underscored that certain, bankruptcy claims, such as creditors' hierarchically ordered claims to a *pro rata* share of the bankruptcy res, are highly interdependent and require coordination. This

language strongly suggests (although the question was technically held open in *Stern*) that the Court is comfortable with the proposition that the claims allowance process in bankruptcy *does* fit within the public rights exception. As such, claims allowance, like the dispute between the Government and the customs agents over customs taxes in *Murray's Lessee*, may be adjudicated in a "summary proceeding" that takes place outside of an Article III tribunal.

- **Discharge injunction.** The Court held in *Taggart v. Lorenzen*, 587 U.S. 554 (2019), that the discharge injunction is enforced through the contempt power. The discussion in *Jarkesy* is consistent with that proposition. The Court reaffirmed that monetary relief may be available for the purpose of "restoring the status quo" without triggering the Seventh Amendment right to a jury trial. *Jarkesy* therefore reaffirms the authority of a court to exercise the equitable authority to enforce the discharge injunction through the contempt power, subject to the usual restrictions on the use of such authority (such as, as *Taggart* explained, the principle that the power should not be exercised where there is a "fair ground of doubt" whether the conduct in question violated the injunction).

- **The automatic stay.** Here is where things get interesting.

    - In cases involving corporate debtors, the automatic stay is also enforced by means of the contempt power. So the application of the stay in such cases should operate in the same way as the discharge injunction. Courts can proceed, without any concern about Article III or the Seventh Amendment, to use the contempt power to impose monetary sanctions for the purposes of "restoring the status quo" when the stay is violated.

    - In cases involving individual debtors, things are more complicated. That is because 11 U.S.C. § 362(k) creates a cause of action for compensatory and punitive damages. Under the rationale of *Jarkesy*, this cause of action certainly seems designed to "punish or deter" stay violations. For that reason, under *Jarkesy*, it seems likely that a Court would conclude that the claim is "legal in nature" and thus triggers the Seventh Amendment.

The question, then, is whether the action falls within the "public rights exception" (like claims allowance) or is sufficiently severable that (like fraudulent conveyance claims) that it falls outside the exception. On this question, fair arguments can be made on both sides. On the one hand, *Jarkesy*'s description of the role of the "public rights" exception in bankruptcy cases includes a concern over creditors' "rush to the courthouse to seek payment," which is precisely what the automatic stay is designed to guard against. On this view, one can certainly describe claims for automatic stay violations as fitting within the public rights exception to the Seventh Amendment. On the other hand, one can also make

the case that an adversary proceeding seeking compensatory and punitive damages (as Bankruptcy Rule 7001 would require) is "sufficiently severable" from the main bankruptcy that it should be viewed more like the fraudulent conveyance action in *Granfinanciera*, and therefore falls outside of the public rights exception. *See generally* Ralph Brubaker, *On 'Summary' Statutory and Constitutional Theory of Bankruptcy Judges' Core Jurisdiction After Stern v. Marshall*, 86 Am. Bankr. L. J. 121, 184-185 (2012) (suggesting that *Stern* calls into question the authority to adjudicate, in bankruptcy court, "the entire category of core 'arising under' proceedings).

Splits and Confounding Issues Destined for the Supreme Court

ABI' Views from the Bench

Supreme Court Round-Up

Washington, D.C.; Sept. 27, 2024

Bill Rochelle • Editor-at-Large
American Bankruptcy Institute
bill@abi.org • 703. 894.5909

99 Canal Center Plaza, Suite 200 • Alexandria, VA 22314 • www.abi.org

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Supreme Court

Last Term

Justice Gorsuch for the majority bans third-party releases for those who don't surrender all their assets to the court, and that would be broader than a discharge.

Supreme Court Reverses *Purdue*: No Nondebtor, Third-Party, Nonconsensual Releases

In a 5/4 decision, the Supreme Court reversed the Second Circuit's *Purdue* decision and declined an invitation to anoint chapter 11 as the remedy for deficiencies in the state and federal tort systems.

In his 20-page majority opinion June 27, Justice Neil M. Gorsuch defined the question before the Court as "whether a court in bankruptcy may effectively extend to nondebtors the benefits of a Chapter 11 discharge usually reserved for debtors." He held "that the bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of affected claimants."

Justice Gorsuch telegraphed the outcome when he said in the very first paragraph that the owners and executives of the opioid manufacturer were aiming for absolution from claims against them "without securing the consent of those affected or placing anything approaching their total assets on the table for their creditors."

The Profit by the Owners from Opioids

Justice Gorsuch recited the facts and procedural history, focusing on the profits that the owners and managers of the Purdue opioid manufacturer had realized in the years leading up to the filing of the company's chapter 11 case in 2019. In the years before the opioid crisis grabbed national attention, the owners and managers received some 15% of company revenue, compared to about 70% each year after 2007. Ultimately, they received distributions of about $11 billion.

In the original chapter 11 plan, the owners proposed to contribute $4.325 billion, spread over 10 years, in exchange for nonconsensual "releases" of all claims, present and future, that might be brought against them. Justice Gorsuch noted that "thousands" of "opioid victims" voted against the plan. The U.S. Trustee, eight states and others opposed confirmation of the plan.

The bankruptcy court confirmed the plan over objections by the U.S. Trustee, eight states and others. On appeal, the district court reversed and vacated the decision confirming the plan. *In re Purdue Pharma, L.P.*, 635 14 B.R. 26 (S.D.N.Y. 2021). To read ABI's report, click here.

After reversal in district court, the owners contributed another $1.675 billion to the plan to alleviate objections from states. Justice Gorsuch said that the owners' "proposed contribution still fell well short of the $11 billion they received from the company between 2008 and 2016."

On the debtor's appeal, the Second Circuit reversed and reinstated the plan over a dissent. *Purdue Pharma LP v. City of Grand Prairie (In re Purdue Pharma LP)*, 69 F.4th (2d Cir. May 30, 2023). To read ABI's report, click here.

The U.S. Trustee filed an application with the Supreme Court for a stay pending appeal. The Court treated the application as a petition for *certiorari* and granted the petition in August along with a stay. The Court heard argument on December 4.

The Merits and Section 1123(b)(6)

Before turning to Section 1123(b)(6) and the principal reason for reversing the Second Circuit, Justice Gorsuch noted that the owners "have not filed for bankruptcy and have not placed virtually all their assets on the table for distribution to creditors, yet they seek what essentially amounts to a discharge."

If there were any basis for a discharge in favor of nondebtors, Justice Gorsuch said it would be found in Section 1123(b)(6). It provides that a chapter 11 plan may include "any other appropriate provision not inconsistent with the applicable provisions of this title."

The plan proponents argued before the Court that the releases were permissible because they were nowhere prohibited in the Bankruptcy Code. As a so-called catchall subject to the *ejusdem generis* canon, Justice Gorsuch said that the subsection is "not necessarily" given the broadest possible construction but "must be interpreted in light of its surrounding context."

"Viewed with that much in mind," Justice Gorsuch said, "we do not think paragraph (6) affords a bankruptcy court the authority the plan proponents suppose." Rather, he said that "the catchall cannot be fairly read to endow a bankruptcy court with the 'radically different' power to discharge the debts of a nondebtor without the consent of affected nondebtor claimants." The other subsections in Section 1123(b), he said, authorize releases "without consent only to the extent such claims concern the debtor."

Justice Gorsuch said that "no one (save perhaps the dissent) thinks [that the catchall] provides a bankruptcy court with a roving commission to resolve all such problems that happen its way."

Other Grounds for Reversal

In the Bankruptcy Code, Justice Gorsuch found three other grounds for reversal. First, the Code reserves discharges for the debtor. Second, the Code requires the debtor to submit all of the debtor's assets to the court. Furthermore, he said, a discharge is not "unbounded," because some claims are exempted from discharge. The Purdue plan, he said, "transgresses all these limits too."

Third, Justice Gorsuch pointed to Section 524(g)(4)(A)(ii) and said that the Code authorizes nondebtor releases "but does so in only one context," namely, plans dealing with asbestos.

Saying that "word games cannot obscure the underlying reality," Justice Gorsuch rejected the idea that the plan just gave releases to the owners, not discharges.

Prior Law

"History" offers a "third" ground for dismissal, Justice Gorsuch said, observing that "pre-code practice may sometimes inform our interpretation of the code's more 'ambiguous' provisions." From 1800 to 1978, he said,

> No one has directed us to a statute or case suggesting American courts in the past enjoyed the power in bankruptcy to discharge claims brought by nondebtors against other nondebtors, all without the consent of those affected.

As far as policy is concerned, Justice Gorsuch noted arguments going both ways. If a policy decision were to be made, "it is for Congress to make," he said.

What the Opinion Does Not Decide

Justice Gorsuch devoted the last page of his decision to noting what the opinion does not decide. First, he said,

> Nothing in what we have said should be construed to call into question consensual third-party releases offered in connection with a bankruptcy reorganization plan; those sorts of releases pose different questions and may rest on different legal grounds than the nonconsensual release at issue here.

Likewise, he said that the decision does not say "what qualifies as a consensual release," nor does the decision "pass upon a plan that provides for the full satisfaction of claims against a third-party nondebtor." The statement appears to express no view on whether a consensual release must be "opt-in" rather than "opt-out."

Of significance with respect to plans already confirmed, Justice Gorsuch said, "because this case involves only a stayed reorganization plan, we do not address whether our reading of the bankruptcy code would justify unwinding reorganization plans that have already

become effective and been substantially consummated." The statement is pertinent to the confirmed Boy Scouts plan, where an appeal is pending in the Third Circuit. The statement is another way of saying that the opinion says nothing about the validity of the doctrine of equitable mootness.

Holding that "the bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of affected claimants," Justice Gorsuch reversed and remanded.

The Lengthy Dissent

Joined by Chief Justice John G. Roberts, Jr., Sonia Sotomayor and Elena Kagan, Justice Brett Kavanaugh "respectfully" dissented in a 54-page opinion. However, he was dissenting "respectfully but emphatically," which became evident with his choice of language, as the reader will see below.

Justice Kavanaugh said that the majority's decision was "wrong on the law and devastating for more than 100,000 opioid victims and their families." Chapter 11, he said, was designed to prevent a race to the courthouse by vesting "bankruptcy courts with broad discretion to approve 'appropriate' plan provisions. 11 U.S.C. § 1123(b)(6)."

In the case at hand, he said that "the Bankruptcy Court exercised that discretion appropriately — indeed, admirably." It was, he said, a "shining example of the bankruptcy system at work." In making a categorical preclusion of nondebtor releases for "no good reason," he said that the majority "now throws out . . . a critical tool for bankruptcy courts to manage mass-tort bankruptcies like this one."

Justice Kavanaugh said that mass torts "present the same collective-action problem that bankruptcy was designed to address," by preventing "victims from litigating outside of the bankruptcy plan's procedures." He found authority for the releases in Section 1123(b)(6), saying that the word "appropriate" was broad and all-encompassing authority that "empowers a bankruptcy court to exercise reasonable discretion." He said that the majority's decision "flatly contradicts the Bankruptcy Code" and that the Code "does not remotely support that categorical prohibition."

In terms of history, Justice Kavanaugh said that "courts have been approving such nondebtor releases almost as long as the current Bankruptcy Code has existed since its enactment in 1978." He lauded the Second Circuit for having "developed a non-exhaustive list of factors for determining whether a non-debtor release is appropriately employed and appropriately tailored in a given case."

Judge Kavanaugh said that the majority's use of the *ejusdem generis* canon was "dead wrong" for two reasons. "First," he said, "its common thread is factually wrong. And second, its purported common thread disregards the evident purpose of § 1123(b)."

The majority should not have relied on Section 524(g), Justice Kavanaugh said, because the "very text of § 524(g) expressly precludes the Court's inference." He quoted the statute as follows: "'Nothing in [§ 524(g)] shall be construed to modify, impair, or supersede any other authority the court has to issue injunctions in connection with an order confirming a plan of reorganization.' 108 Stat. 4117, note following 11 U.S.C. § 524."

Justice Kavanaugh disagreed with the majority's belief that a release was the same as a discharge. He pointed out that the release only pertains to claims related to Purdue.

Concluding his dissent, Justice Kavanaugh said that the majority's opinion "makes little sense legally, practically, or economically." Pointing to Boy Scouts, the Catholic Church cases, breast implants, Dalkon Shield and others, he said that nondebtor releases "have been indispensable to solving that problem and ensuring fair and equitable victim recovery."

Justice Kavanaugh said that the "Court's decision will lead to too much harm for too many people for Congress to sit by idly without at least carefully studying the issue." If the majority believed that $5.5 billion to $6 billion from the owners was not enough, he said that the Court "at most" should have remanded for the lower courts to decide "whether the releases were 'appropriate' under 11 U.S.C. § 1123(b)(6) (if anyone had raised that argument here, which they have not)."

Note: Justice Kavanaugh said that the U.S. Trustee opposed the plan "for reasons that remain mystifying."

The opinion is *Harrington v. Purdue Pharma L.P.*, 23-124 (Sup. Ct. June 27, 2024).

Reversing the Fourth Circuit, the Supreme Court gives a flexible interpretation to traditional notions of constitutional standing in bankruptcy cases and appeals.

Supreme Court Says that Insurance Neutrality Doesn't Deprive an Insurer of Standing

Reversing the Fourth Circuit, the Supreme Court held that an "insurance neutral" chapter 11 plan does not deprive the insurer of standing to raise objections to the plan. For a unanimous Court, Justice Sonia Sotomayor said, "Courts must determine on a case-by-case basis whether a prospective party has a sufficient stake in reorganization proceedings to be a 'party in interest'" under Section 1109(b).

Justice Sotomayor said that the Fourth Circuit had "conflate[d] the merits of an insurer's objection with the threshold §1109(b) question of who qualifies as a 'party in interest.'"

The Court's June 6 opinion is far from the last word on standing in bankruptcy court or on appeal. In the first place, the case directly deals only with standing in chapter 11. Even in chapter 11 cases, Justice Sotomayor said that "the Court today does not opine on the outer bounds of §1109," the statutory standard governing standing in chapter 11.

The opinion could be read to mean that a creditor can object to a plan and presumably mount an appeal with regard to a provision that does not directly affect that creditor. The opinion does not tell us when a creditor loses standing because the effect is too indirect.

The opinion might also be read to mean that the contemporary notion of "insurance neutrality" is too narrow.

The 'Insurance Neutral' Plan

Facing 14,000 pending lawsuits, the corporate debtor proposed a chapter 11 plan under Section 524(g) to create a trust wiping away present and future asbestos claims. All asbestos claims were to be channeled to a trust.

The principal asset for the trust was the debtor's primary insurance policy, with a coverage limit of $500,000 per claim. The insurer was obliged by the policy to defend and indemnify the debtor, even if the claim were false or fraudulent. Defense costs were not counted against the

policy limit for each claim, meaning that the policy was non-eroding. More to the consternation of the insurer, policy had no maximum aggregate limit.

The plan divided asbestos claims into two classes: (1) insured claims covered by the policy; and (2) uninsured claims not covered by the policy. Uninsured claims, of which there were few, were to be paid entirely by the trust.

Claims covered by insurance were to be litigated nominally against the debtor in the tort system, but subject to the coverage limit for each claim. The trust would pay the $5,000 deductible for each insured claim.

The claims covered by insurance remained subject to the insurer's prepetition coverage defenses. In short, the insurer was on the hook for any claim that fell under the policy under the unmodified terms of the policy.

The uninsured claims were subject to antifraud provisions under the plan to protect the trust by requiring the claimants to provide disclosures designed to avoid fraud and duplicate claims. The case came to the Supreme Court because the plan had no antifraud provisions for insured claims.

Unsecured creditors were to be paid in full.

The only class impaired by the plan, asbestos claimants, voted unanimously in favor of the plan. The only confirmation objection came from the insurer, which was not entitled to vote because its unsecured claim would be paid in full and it retained all its rights under the insurance policy.

For lack of antifraud provisions applicable to insured claims, the insurer contended that the plan was not proposed in good faith and was not insurance neutral. The bankruptcy court wrote an opinion recommending that the district court approve the plan, finding that it was insurance neutral and filed in good faith. Because the plan was insurance neutral, the bankruptcy court concluded that the insurer was not a party in interest under Section 1109(b) and thus lacked standing to challenge the plan.

The district court confirmed the plan, adopting the bankruptcy court's findings *in toto* after *de novo* review.

On appeal, the Fourth Circuit affirmed. *Truck Insurance Exchange v. Kaiser Gypsum Co. (In re Kaiser Gypsum Co.)*, 60 F.4th 73 (4th Cir. Feb. 14, 2023). *cert. granted sub nom. Truck Ins. Exch. v. Kaiser Gypsum Co.*, No. 22-1079, 2023 WL 6780372 (Oct. 13, 2023). To read ABI's report on the Fourth Circuit affirmance, click here.

The Fourth Circuit found the plan to have been "insurance neutral," giving the insurance company no standing in the bankruptcy court or on appeal to object to the merits of the plan pertaining to any aspects of the plan other than insurance neutrality. In a footnote, the appeals court said that the insurer had Article III, or constitutional, standing to challenge the finding of insurance neutrality.

The insurer filed a petition for *certiorari*, urging the Court to resolve a split of circuits. The Court granted *certiorari* in October. Argument took place on March 19. It was the last of three bankruptcy cases to be argued this term but the first to be decided.

Section 1109(b) Is 'Capacious'

Without directly mentioning the constitutional restraint on standing imposed by the case or controversy requirement under Article III of the Constitution, Justice Sotomayor stated the question as "whether an insurer with financial responsibility for a bankruptcy claim is a 'party in interest' under" Section 1109(b).

The section provides that "[a] party in interest . . . may appear and be heard on any issue in a case under this chapter." The section goes on to say that parties in interest include "the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee."

Parsing the statute, Justice Sotomayor said that the "text is capacious." She found a "common thread [that] the seven listed parties . . . may be directly affected by a reorganization plan." She cited the Court's own precedent for saying "that Congress uses the phrase 'party in interest' in bankruptcy provisions when it intends the provision to apply 'broadly.' " *Hartford Underwriters Ins. Co.* v. *Union Planters Bank, N. A.*, 530 U. S. 1, 7 (2000). Consulting a dictionary, she concluded that "parties in interest" refers "to entities that are potentially concerned with or affected by a proceeding."

Justice Sotomayor girded her broad reading of "party in interest" by reference to "historical context and purpose." Historically, she noted how adoption of the Bankruptcy Code in 1978 "moved from an exclusive list to the general and capacious term 'party in interest,' accompanied by a nonexhaustive list of parties in interest."

In terms of purpose, the justice said, "Broad participation promotes a fair and equitable reorganization process."

Alleged Collusion Gave Rise to Standing

Applying general principles to the facts of the case, Justice Sotomayor noted how the insurer had alleged collusion between the debtor and asbestos claimants by including no antifraud

provisions in the plan to protect the insurer. The allusion to alleged collusion led immediately to a finding of standing, when she said,

> An insurer with financial responsibility for bankruptcy claims can be directly and adversely affected by the reorganization proceedings in these and many other ways, making it a "party in interest" in those proceedings.

Note the reference to "directly and adversely," terms that are used in defining standing under Article III of the Constitution. The reference means that Justice Sotomayor was anchoring the notion of standing under Section 1109(b) to traditional concepts of constitutional standing.

Critique of 'Insurance Neutral'

Justice Sotomayor devoted the remainder of her 15-page opinion to a refutation of the Fourth Circuit's analysis finding no standing to challenge the plan. "Conceptually," she said,

> [T]he insurance neutrality doctrine conflates the merits of an objection with the threshold party in interest inquiry. The §1109(b) inquiry asks whether the reorganization proceedings might affect a prospective party, not how a particular reorganization plan actually affects that party.

Justice Sotomayor explained that insurance neutrality is "too limited in scope" and "zooms in on the insurer's prepetition obligations and policy rights. That wrongly ignores all the other ways in which bankruptcy proceedings and reorganization plans can alter and impose obligations on insurers."

Observing that insurance neutrality does not coincide with lack of standing, Justice Sotomayor might be understood as not telling the Fourth Circuit to reverse on the merits following remand, when she said,

> Whether and how the particular proposed Plan here affects [the insurer's] prepetition and postpetition obligations and exposure is not the question. The fact that [the insurer's] financial exposure may be directly and adversely affected by a plan is sufficient to give [the insurer] . . . a right to voice its objections in reorganization proceedings.

The Narrow Opinion

Section 1109 applies only in chapter 11. The section does not generally confer standing on shareholders or debtors in chapter 7, for example. Justice Sotomayor concluded her opinion by saying that "the Court today does not opine on the outer bounds of §1109." However, she quoted

the *Collier* treatise, saying that "a party in interest is 'not intended to include literally every conceivable entity that may be involved in or affected by the chapter 11 proceedings.'"

Despite the paucity of *dicta* prescribing rules for other cases, the opinion is not silent. Just before reversing and remanding, Justice Sotomayor dropped a quote with the words "truly peripheral" that will be used in the future to define when a party's interest is insufficient to confer standing.

Justice Sotomayor said, "There may be difficult cases that require courts to evaluate whether truly peripheral parties have a sufficiently direct interest. This case is not one of them."

Judges in the future will tell us what "truly peripheral" means. Some courts might question whether there is standing in a case where the interest is more than "peripheral." Nonetheless, *dicta* from the Supreme Court is highly persuasive, to say the least.

Observations

The opinion is narrow. It does not define the outer limits of standing; it does not deal with chapters 7, 12 and 13, and it does not explicitly say whether the more exacting "person aggrieved" standard for appellate standing in some circuits survived adoption of the Bankruptcy Code.

A "person aggrieved" is typically defined as a party who is directly and adversely affected pecuniarily. Without saying so directly, the opinion seems to replace "person aggrieved" for appellate standing with a less exacting standard.

Perhaps Section 1109(b) can be seen as presumptively bestowing standing on the enumerated parties, because Congress cannot grant standing broader than Article III permits.

The opinion does not tell us whether stockholders, for instance, will always have standing in chapter 11. Can the presumption be overcome if the bankruptcy court conducts a hearing and decides that the debtor is hopelessly insolvent and that shareholders lack standing?

By saying that "truly peripheral parties" can lack standing, is Justice Sotomayor telling us that Section 1109(b) would be unconstitutional as applied if a peripheral party was granted standing?

The opinion does seem to open the door to conferring standing for more wide-ranging appellate attacks on confirmation and other orders of the bankruptcy court. The opinion may enable more appeals to survive motions to dismiss. Often, though, appellate courts will have an easier time ruling on the merits than deciding nettlesome issues about standing.

Because standing is jurisdictional, appellate courts must address the question before tackling the merits. The opinion provides appellate courts with more leeway to find standing and reach the merits.

The opinion is *Truck Ins. Exch. v. Kaiser Gypsum Co.*, 22-1079 (Sup. Ct. June 6, 2024).

Saying that the constitutional infirmity was "small" and "short-lived," the majority decided that prospective relief was enough because Congress subsequently enacted a law mandating uniformity in the future with regard to fees for U.S. Trustees and Bankruptcy Administrators.

No Refunds for Overpayment of Unconstitutional U.S. Trustee Fees, Supreme Court Rules

Differing with all four circuits that had held to the contrary, the Supreme Court ruled in a 6/3 decision on June 14 that chapter 11 debtors in 48 states who paid $326 million in unconstitutionally higher U.S. Trustee fees are not entitled to refunds.

The Supreme Court decided two years ago that the 2018 increase in U.S. Trustee fees paid by chapter 11 debtors was unconstitutional because it was not immediately applicable in the two states with Bankruptcy Administrators rather than U.S. Trustees. *Siegel v. Fitzgerald*, 142 S. Ct. 1770 (Sup. Ct. June 6, 2022). *Siegel* explicitly left open the question of whether debtors who had paid too much were entitled to refunds. To read ABI's report, click here.

Justice Ketanji Brown Jackson wrote the opinion of the Court nixing the idea of refunds. The majority held that "prospective parity" was a sufficient remedy, because Congress had amended the statute in 2020 to ensure that fees would always be uniform in the future. Justice Neil M. Gorsuch penned a dissent joined by Justices Clarence Thomas and Amy Coney Barrett.

The Constitutional Violation in *Siegel*

The fees paid by chapter 11 debtors to the U.S. Trustee program increased in 2018, but the increase did not become effective for 10 months in the two states that have Bankruptcy Administrators rather than U.S. Trustees. In U.S. Trustee districts, the increase applied to pending cases, but the increase did not apply to pending cases in Bankruptcy Administrator districts. The circuits were split 2/2 on whether the increase violated the uniformity aspect of the Bankruptcy Clause of the U.S. Constitution.

Unanimously, the Supreme Court resolved the split in *Siegel* by finding a violation of the Bankruptcy Clause.

Before *Siegel* came to the Supreme Court, the Fourth Circuit had not reached the question of remedy because the appeals court had found no constitutional violation. Reversing and leaving

open the question of remedy, the Court in *Siegel* remanded for the appeals court to consider the question of refunds.

Hammons Fall on Remand

Before *Siegel* came to the Supreme Court, the Tenth Circuit had ruled in *Hammons Fall* that the disparate fee increase was unconstitutional and called for a refund. Having lost in the circuit, the government had filed a petition for *certiorari* in *Hammons Fall*. One year ago, the Supreme Court granted the *certiorari* petition, vacated the judgment and "remanded for further consideration in light of *Siegel*."

On remand in the Tenth Circuit, the government strenuously argued that the debtor was not entitled to a refund, because Congress had already supplied prospective relief by a technical amendment in 2020 that mandates fee uniformity going forward in U.S. Trustee and Bankruptcy Administrator districts.

Last August, the Tenth Circuit "reinstate[d] our original opinion," which required the government to pay a refund based on what the debtor would have paid were it in a Bankruptcy Administrator district. The government filed another petition for *certiorari*, which the Supreme Court granted in late September. The Court heard oral argument on January 9. As we said in this space after argument, the justices "who spoke seemed skeptical about the idea that the remedy for a due process violation requires refunds to those who paid too much."

'Small' Violations Don't Merit a Refund

Justice Jackson carefully laid out the procedural history before turning to the merits.

"Across remedial contexts," Justice Jackson cited the Court's precedent to say that "'the nature of the violation determines the scope of the remedy.'" *Swann v. Charlotte-Mecklenburg Bd. of Ed.*, 402 U.S. 1, 16 (1971). Citing other precedent, she said that the Court tries to limit the solution to the problem when there is a constitutional flaw in a statute. Precedent therefore called for her to "bear down upon the particulars of the constitutional violation we identified in *Siegel*."

Referring to the constitutional violation, Justice Jackson said that the flaw was in the lack of uniformity, not in higher fees. She then said that "the fee disparity at issue here was short lived" and "small."

The disparity was "small," Justice Jackson said, because lower fees were paid in only 2% of chapter 11 cases and that "98% of the relevant class of debtors still paid uniform fees." She quickly drew the conclusion that "Congress likely would not have intended relief that is impractical or unworkable." Instead, she said that "Congress would have wanted prospective parity, not a refund or retrospective raising of fees."

Furthermore, Justice Jackson said that requiring refunds would cause "extreme disruption" and would "would significantly undermine Congress's goal of keeping the U.S. Trustee Program self-funded." She added that refunds would cost the government "approximately $326 million." In short, refunds "would transform a program Congress designed to be self-funding into an enormous bill for taxpayers."

Delving further into the facts, Justice Jackson cited the government for saying that 85% of the chapter 11 cases eligible for refunds had already been closed. Consequently, she said that the debtor offered "no meaningful path to reducing the small existing disparity through refunds."

In sum, Justice Jackson said that "Congress would have wanted prospective parity, and that remedy is sufficient to address the small, short-lived disparity caused by the constitutional violation we identified in *Siegel*."

Justice Jackson devoted the last four pages of her opinion to refuting the dissenters. Of perhaps principal significance, she answered the dissenters' argument that refunds were required in view of the Court's awards of refunds in tax cases. Analyzing the tax cases, she concluded that the debtor is "not entitled to relief under them."

Justice Jackson reversed and remanded, holding that Congress' requirement of uniform fees going forward "cures the constitutional violation, and due process does not require another result."

The Dissent

Overall, Justice Gorsuch seemed concerned that the precedent being set by the bankruptcy opinion would deprive plaintiffs of remedies in other cases with constitutional violations. In the first paragraph of dissent, he said, "What's a constitutional wrong worth these days? The Court's answer today seems to be: not much."

Seeing the majority as having departed from precedent, Justice Gorsuch said,

> Never mind that a refund is the traditional remedy for unlawfully imposed fees . . . . As the majority sees it, supplying meaningful relief is simply not worth the effort. Respectfully, that alien approach to remedies has no place in our jurisprudence.

Failing to see the fee disparity as "small," Justice Gorsuch noted that the debtor had paid $2.5 million in unconstitutionally excessive fees. He said that the Court's "longstanding precedent should make short work of this case" and that "[t]raditional remedial principles" require monetary relief. For him, "the majority's *prospective* remedy for a *past* injury is no remedy at all." [Emphasis in original.]

Apart from traditional remedies given for constitutional violations, Justice Gorsuch said that the "this Court's due process precedents would demand the same result." He disputed the majority's conclusion that "our due process precedents are limited to the tax context."

Justice Gorsuch said that he "struggle[d] to understand why today the majority so readily dismisses any remedy in this case . . . . One possibility is that the majority views Bankruptcy Clause violations as less worthy of relief than other constitutional violations."

The "other possibility," Justice Gorsuch said, was the majority's belief that "supplying relief isn't worth the trouble because the constitutional violation at issue here was, as the majority puts it, "'short-lived and small.'" How could it be "small," he said, "when it cost [the debtor] $2.5 million and, as the majority itself emphasizes, cost others millions more?"

"Respectfully" dissenting, Justice Gorsuch ended his opinion by considering "what [the majority's] kind of thinking could mean for those seeking retrospective relief for other constitutional violations." He could imagine "today's decision receiving a warm welcome from those who seek to engage in only a dash of discrimination or only a brief denial of some other constitutionally protected right."

"The rest of us can only hope that the Court corrects its mistake before it metastasizes too far beyond the bankruptcy context," Justice Gorsuch said in the last sentence of his dissent.

Observation

The opinion has implications for every debtor that was in chapter 11 when the U.S. Trustee fees increased. There is a class action pending in the Court of Federal Claims in Washington, D.C., aiming to recover refunds for debtors nationwide who paid too much. *See Acadiana Management Group LLC v. U.S.*, 19-496 (Ct. Cl.). The plaintiff in the class action seems to be facing an uphill fight after the Supreme Court's decision.

The plaintiff in *Acadiana* is not giving up, however. "We are accepting Justice Gorsuch's invitation in footnotes 4 and 9 of his dissent to continue to litigate the class action," Bradley Drell told ABI.

In footnote nine, Justice Gorsuch said, "Given the weight the majority places on [the debtor's] inability to recover for all affected debtors, it's far from clear what the impact of today's decision is on [the *Acadiana* class] action." Mr. Drell, from Gold, Weems, Bruser, Sues & Rundell in Alexandria, La., is counsel for the plaintiff in *Acadiana*.

The opinion is *Office of the U.S. Trustee v. John Q. Hammons Fall 2006 LLC*, 22-1238 (Sup. Ct. June 14, 2024).

A Supreme Court nonbankruptcy decision means there is no right to a jury trial in the claims-allowance process in bankruptcy.

Supreme Court's *Jarkesy* Opinion Clarifies *Granfinanciera* on Jury Trial Rights

At the end of the term, the Supreme Court decided a nonbankruptcy case that puts to rest several bankruptcy questions arising in the wake of *Northern Pipeline*, *Granfinanciera* and *Stern v. Marshall*.

In this writer's view, *SEC v. Jarkesy*, 144 S. Ct. 2117, 219 L. Ed. 2d 650 (June 27, 2024), tells us definitively that a defendant in a fraudulent transfer suit brought under Section 548 is entitled to a jury trial in district court. Of perhaps greater significance, there is no right to a jury trial or final adjudication in district court in claims allowance, even if the creditor were entitled to a jury trial had there been no bankruptcy.

Although fair minds might differ, this writer also reads *Jarkesy* to mean that the bankruptcy court may impose sanctions for violations of the discharge injunction and the automatic stay as long as the sanctions are civil, not criminal.

Dodd Frank and *Jarkesy*

In the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, Congress for the first time gave the Securities and Exchange Commission the power in administrative proceedings before an administrative law judge (ALJ) to impose penalties for violations of securities law.

Invoking Dodd Frank and proceeding before an ALJ, the SEC imposed a $300,000 civil penalty and other sanctions on an individual for violations of antifraud provisions of securities laws. The Fifth Circuit reversed in a divided opinion, invoking *Granfinanciera, S. A. v. Nordberg*, 492 U. S. 33 (1989). Because the enforcement action was not conducted in federal district court, the appeals court found a violation of Seventh Amendment jury trial rights.

The Supreme Court granted *certiorari* and affirmed on June 27 in a 6/3 opinion by Chief Justice John G. Roberts, Jr. Justice Sonia Sotomayor penned a dissent joined by Justices Elena Kagan and Ketanji Brown Jackson. Justice Neil M. Gorsuch wrote a concurring opinion joined by Justice Clarence Thomas. The three opinions totaled 98 pages.

Granfinanciera Clarified

For the majority, the Chief Justice ruled that the so-called public rights exception to the Seventh Amendment did not apply for reasons explicated in *Granfinanciera*. But first, he explained why there were Seventh Amendment rights.

Citing *Granfinanciera*, the Chief Justice said that the "Seventh Amendment extends to a particular statutory claim if the claim is 'legal in nature.'" Furthermore, it is "immaterial" whether the claim is statutory.

Because some claims are both equitable and legal in nature, the Chief Justice said that "the remedy is all but dispositive." Given that the SEC's civil penalties were to punish and deter, not compensate, he concluded that the remedy was at common law and conferred jury trial rights.

Even though jury trial rights were in play, the government argued that the public rights exception applied and deprived the offender of Seventh Amendment rights.

Citing *Granfinancera*, *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co*., 458 U. S. 50 (1982), and *Stern v. Marshall*, 564 U. S. 462 (2011), the Chief Justice said that the Court has "repeatedly explained that matters concerning private rights may not be removed from Article III courts." He went on to say that "the matter presumptively concerns private rights, and adjudication by an Article III court is mandatory" if the "suit is in the nature of an action at common law."

In an understatement reflecting the Court's conflicting jurisprudence, the Chief Justice conceded that the "Court 'has not "definitively explained" the distinction between public and private rights,' and we do not claim to do so today."

Granfinanciera held the key to the decision because it was a case in which Congress purported to take away jury trial rights by installing a claim for fraudulent transfer in Article I bankruptcy courts even though "fraudulent conveyance [actions] were well known at common law," the Chief Justice said. Digging deeper into *Granfinanciera*, he said that fraudulent transfer actions, unlike the claims-allowance process, "were not 'closely intertwined' with the bankruptcy process."

Saying that "*Granfinanciera* effectively decides this case," the Chief Justice affirmed the Fifth Circuit because a "defendant facing a fraud suit has the right to be tried by a jury of his peers before a neutral adjudicator."

Observations

The opinion of the Court effectively says that the bankruptcy claims-allowance process implicates public rights because the rights and recoveries of other creditors are affected by the

outcome of claim objections. *Jarkesy* eliminates any arguments that might remain about the right to a jury in deciding the validity or amount of claims.

The Court's discussion of *Granfinanciera* also eliminates any idea that fraudulent transfer suits could be litigated to finality in bankruptcy court if the defendant has neither filed a claim nor waived an objection to the jurisdiction and power of the bankruptcy court.

When it comes to the right to a jury trial for violations of the automatic stay or the discharge injunction, the implications of *Jarkesy* are more opaque. In *Taggart v. Lorenzen*, 139 S. Ct. 1795, 1799 (2019), the Court held unanimously that the bankruptcy court "may impose civil contempt sanctions when there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful under the discharge order." However, *Taggart* does not deal with jury trial rights.

Citing *Tull v. United States*, 481 U. S. 412, 422 (1987), the Chief Justice indicated in *Jarkesy* that public rights are implicated when the relief is "solely to 'restore the status quo.'" By that token, civil sanctions for violations of discharge or the automatic stay seem to involve the restoration of the status quo, disabling a violator from claiming the right to a jury trial.

Some might argue that the invocation of public rights should not apply to the imposition of punitive damages under Section 362(k) for the willful violation of a stay protecting an individual debtor. This writer believes that the more draconian sanctions in Section 362(k) were imposed by Congress to ward off creditors' temptations to pursue individuals who, given their bankrupt status, lack the wherewithal to act against violators.

Whatever the sanctions may be for violation of the automatic stay, they are "closely intertwined" with the bankruptcy process because the automatic stay and discharge are the principal remedies afforded debtors under the Bankruptcy Code. Being "closely intertwined" with the enforcement of debtors' remedies, sanctions seem to this writer to fall within the public rights exception.

The opinion is *SEC v. Jarkesy*, 144 S. Ct. 2117, 219 L. Ed. 2d 650 (June 27, 2024).

The unanimous decision on March 19 by Justice Gorsuch contains language that could be used on both sides of the argument about the validity of equitable mootness.

Supreme Court Rules on Mootness, but Not Equitable Mootness

In the world of bankruptcy, the validity of the doctrine of equitable mootness is an issue that the Supreme Court has been ducking. On March 19, the Court handed down a non-bankruptcy decision on constitutional mootness. Although the unanimous decision by Justice Neil M. Gorsuch includes quotations that could be employed on both sides of the argument, the opinion doesn't give a solid clue on how the justices would rule on the validity of equitable mootness.

Equitable mootness is not a product of Article III's requirement that there must be a case or controversy. When equitable mootness is invoked to dismiss an appeal, there typically is an extant case or controversy.

Not based on the Constitution, equitable mootness is a prudential doctrine — that is, something invented by courts. Most often, equitable mootness is invoked to dismiss an appeal from an order confirming a chapter 11 plan.

Although the circuits are not uniform in their application of the doctrine, three factors usually resulting in a finding of equitable mootness are the lack of a stay pending appeal, substantial consummation of the plan and an adverse effect on parties not before the court on appeal.

The 'No-Fly' List

The individual in the case before the Supreme Court was born in Eritrea and lived in Sudan before his family moved to the U.S., where he became a citizen. As an adult, he traveled to Sudan on business.

While in Sudan, he was told by U.S. officials that he was on the no-fly list and could not return to the U.S. While still abroad some years later, he sued the U.S. government, claiming a due process violation for having no notice about the basis for his classification and no method to secure redress.

Soon after the suit was filed, the government removed him from the no-fly list and then moved to dismiss the suit as moot. In support of dismissal, the government said that he would not be placed on the no-fly list in the future "based on currently available information."

The district court twice dismissed the case as moot, but the Ninth Circuit twice reversed, not seeing the case as moot. To resolve a circuit split, the Supreme Court granted the government's petition for *certiorari*.

The Merits

When there is a case or controversy as Article III requires, Justice Gorsuch cited Supreme Court precedent for saying that federal courts have a "virtually unflagging obligation" to hear the case. "But," he said, "events in the world overtake those in the courtroom, [when] a complaining party manages to secure outside of litigation all the relief he might have won in it."

"When that happens," Justice Gorsuch said, "a federal court must dismiss the case as moot." He added, "federal judges are not counselors or academics; they are not free to take up hypothetical questions that pique a party's curiosity or their own."

Of possible application to the bankruptcy world, Justice Gorsuch said:

> The limited authority vested in federal courts to decide cases and controversies means that they may no more pronounce on past actions that do not have any "continuing effect" in the world than they may shirk decision on those that do.

Justice Gorsuch went on to say:

> [O]ur precedents hold [that] a defendant's "'voluntary cessation of a challenged practice'" will moot a case only if the defendant can show that the practice cannot "'reasonably be expected to recur.'" [Citations omitted.]

Also of possible application to equitable mootness, Justice Gorsuch said, "a defendant might suspend its challenged conduct after being sued, win dismissal, and later pick up where it left off," were it easier to show mootness.

Affirming the circuit court, Justice Gorsuch decided that the case was not moot because the government's statement only referred to reliance on actions taken in the past. "[N]one of that," he said, "speaks to whether the government might relist him if he does the same or similar things in the future."

"In all cases," Justice Gorsuch said, "it is the defendant's 'burden to establish' that it cannot reasonably be expected to resume its challenged conduct."

Observations

The opinion by Justice Gorsuch is founded on the notion that a case is not moot if the defendant can take the challenged action again in the future. In the bankruptcy sphere, cases found to be equitably moot usually deal with legal questions that are likely to recur in other cases.

Perhaps fatally so, the Supreme Court's decision is distinguishable because the same creditor in a bankruptcy case would not be raising the same question in the future against the same debtor.

The question is this: Does the Supreme Court's focus on the ability of someone to raise the same issue suggest that the high court would frown on equitable mootness regarding a question that's endemic in bankruptcy cases?

The opinion is *F.B.I v. Fikre*, 22-1178 (Sup. Ct. March 19, 2024).

The Supreme Court again retreated from the idea that there's a strong federal policy in favor of arbitration.

Supreme Court Ruled Again on Arbitration, but Not (Yet) in Bankruptcy Cases

When the Supreme Court writes an opinion on arbitration, we pay attention because the high court will decide, one of these days, whether or when arbitration agreements are enforceable in bankruptcy.

Will the Supreme Court say that arbitration is always enforceable? (Unlikely.) Or, will arbitration never be enforceable in bankruptcy? (Also unlikely.)

What's the dividing line? Will arbitration be enforceable if the dispute is noncore but unenforceable if it's core?

Once there's a final order, bankruptcy disputes are appealable. Will the lack of appeal from an arbitration award factor into the question about enforceability of arbitration agreements in bankruptcy cases?

And finally, will arbitration agreements be enforceable against a debtor in possession but not against a trustee, because a trustee will not have been a party to the arbitration agreement?

If anything, the latest arbitration decision from the Supreme Court on April 12 implies a broader interpretation of exceptions to arbitration.

The Employer Was a Commercial Bakery

The case involved one of the country's largest commercial bakeries. Two individuals were local distributors for the bakery, which had plants in 19 states and distribution throughout the country.

The bakery delivered baked goods to a warehouse, where they were picked up by the distributors and sold to retailers in the state. In a purported class action, the distributors sued the bakery in federal district court for violations of federal labor laws.

The distributorship agreement had a clause saying that "any claim" must be arbitrated. The bakery filed a motion to compel arbitration. The outcome turned on an exception to arbitration contained in the Federal Arbitration Act, 9 U.S.C. § 1. The section says that "nothing herein

contained shall apply to contracts of employment of seamen, railroad employees, *or any other class of workers engaged in foreign or interstate commerce.*" [Emphasis added.]

The district court granted the motion to compel arbitration and was upheld in the Second Circuit, over dissent. According to the unanimous, nine-page opinion by Chief Justice John G. Roberts, Jr., the majority on the Second Circuit reasoned that the bakery was in the baking business, not in the transportation business, making the exception inapplicable.

The Supreme Court granted *certiorari* to resolve a split with the First Circuit.

Focus on the Employee, Not the Employer

Justice Roberts surveyed the Supreme Court's more recent authorities on arbitration, noting how the Court had ruled in 2001 that the exception in Section 1 "is limited to transportation workers." *Circuit City Stores Inc. v. Adams*, 532 U.S. 105 (2001). Later, the Court said that the exception applies to workers who are "engaged" in commerce and does not turn on the industry of the employer.

The relevant question, Justice Roberts said, asks what the employee does for the employer, not what the employer does. Thus, he said, "A transportation worker need not work in the transportation industry to fall within the exemption from the FAA provided by § 1 of the Act."

The Chief Justice ruled that the Second Circuit "erred in compelling arbitration on the basis that petitioners work in the bakery industry." He vacated the judgment of the Second Circuit and remanded for further proceedings, expressing "no opinion on any alternative grounds in favor of arbitration raised below, including that petitioners are not transportation workers . . . ."

Observation

The opinion is another example showing the Supreme Court's retreat from the idea that there is a strong federal policy in favor of arbitration.

As Justice Elena Kagan said in May 2022, "The policy is to make 'arbitration agreements as enforceable as other contracts, but not more so.' *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404, n. 12 (1967)." *Morgan v. Sundance Inc.*, 596 U.S. 411, 42 S. Ct. 1708, 1713 (Sup. Ct. May 23, 2022). To read ABI's report, click here.

In bankruptcy, keep in mind that contracts are not enforceable in all respects. Similarly, forum-selection clauses largely yield to the Bankruptcy Code.

If arbitration agreements are enforceable like any other contract in bankruptcy, perhaps arbitration clauses are only enforceable when a debtor is suing someone who has not filed a proof

of claim or otherwise submitted to jurisdiction. Perhaps courts will say that an arbitration agreement by a debtor does not bind a trustee because the trustee did not sign the arbitration agreement.

The opinion is *Bissonnette v. LePage Bakeries Park St. LLC*, 23-51 (Sup. Ct. April 1, 2024).

Next Term

To resolve a circuit split, the Supreme Court has agreed to decide whether a trustee can sue the government to recover a fraudulent transfer under state law when sovereign immunity would bar an 'actual creditor' from suing.

Supreme Court to Rule on Waiver of Sovereign Immunity for Suits Under Section 544(b)(1)

To resolve a split of circuits, the Supreme Court has granted *certiorari* to decide whether the waiver of sovereign immunity in Section 106(a) permits a bankruptcy trustee to sue the federal government for receipt of a fraudulent transfer under Section 544(b)(1), when an actual creditor could not sue the government outside of bankruptcy.

One year ago in *U.S. v. Miller*, 71 F.4th 1247 (10th Cir. June 27, 2023), the Tenth Circuit sided with the Ninth and Fourth Circuits, which both had held that the waiver of immunity in Section 106(a) allows claims against the government under state law. *See In re DBSI, Inc.*, 869 F.3d 1004 (9th Cir. 2017); and *Cook v. U.S. (In re Yahweh Center Inc.),* 27 F.4th 960 (4th Cir. 2022). To read ABI's reports, click here and here. To read ABI's report on *Miller* in the Tenth Circuit, click here.

There is a circuit split because the Seventh Circuit held to the contrary in 2014 by ruling that the immunity waiver in Section 106(a) did not allow suit, reasoning that Section 106(a) did not modify the actual creditor requirement in Section 544(b). *See In re Equip. Acquisition Res. Inc.*, 742 F.3d 743 (7th Cir. 2014).

Fraudulent Transfer to the IRS

The Internal Revenue Service is often the recipient of constructive fraudulent transfers, for example, when a corporation pays federal income taxes owing by one of the owners. And so it was in the case before the Tenth Circuit last year.

The corporation's chapter 7 trustee brought suit in bankruptcy court against the IRS under Section 544(b)(1) for receipt of a constructively fraudulent transfer under Utah law. The section allows a trustee to "avoid any transfer of an interest of the debtor in property . . . *that is voidable under applicable law by a creditor holding an [allowable] unsecured claim.*" [Emphasis added.]

The government conceded that there was an actual creditor and did not contest the elements of a constructively fraudulent transfer. However, the government contended that sovereign immunity would have prevented an actual creditor from suing the IRS outside of bankruptcy. Without an

actual creditor to raise the fraudulent transfer claim, the government contended that the bankruptcy trustee was precluded from suing under Section 544(b)(1).

On cross motions for summary judgment, Bankruptcy Judge R. Kimball Mosier of Salt Lake City ruled in favor of the trustee and entered judgment for about $145,000. The IRS appealed, but the district court affirmed. *See U.S. v. Miller*, 20-00248, 2021 BL 340200 (D. Utah Sept. 8, 2021). To read ABI's report on the district court affirmance, click here.

On the government's second appeal, the Tenth Circuit agreed with the trustee's theory that the broad waiver of sovereign immunity applicable to Section 544 by virtue of Section 106(a) allowed suit based on a state-law claim. The Tenth Circuit affirmed the two lower courts and parted company with the Seventh Circuit. *U.S. v. Miller, supra*.

After two extensions of time, the U.S. Solicitor General filed a petition for *certiorari* on January 29. The Court considered the petition in conference on June 17 and granted the petition on June 24. The grant was not surprising because there is a circuit split, and the Court grants review about half the time when the federal government files a petition for *certiorari*.

The Government's Theory

The Solicitor General urged the high court to resolve the circuit split because "bankruptcy courts have frequently addressed this question over the last two decades" and reached decisions that the government believes were wrong.

If the allegedly fraudulent transfer to the IRS had occurred within two years of bankruptcy, the trustee could have maintained suit under Section 548 because that section is one of those listed in Section 106(a) as to which sovereign immunity is "abrogated." Since the transfer occurred more than two years before bankruptcy and less than the four years permitted by Utah law, the trustee was compelled to sue under Section 544(b)(1) with its "actual creditor" requirement.

The government believes that the Tenth Circuit was wrong because "no actual creditor could obtain relief outside of bankruptcy," given the government's sovereign immunity. "Because no actual unsecured creditor could have avoided the federal tax payments at issue here under Utah fraudulent-transfer law," the government argues that "the Chapter 7 trustee had nobody's shoes to step into when seeking to avoid those tax payments under Section 544(b) by invoking that state law."

Indeed, the government believes that Section 106(a) has "no bearing" on the outcome because the waiver of sovereign immunity does not alter the substantive requirement in Section 544(b) that there must be an "actual creditor" entitled to sue.

The date for oral argument had not been set. If the parties do not request a lengthy extension of time to file their briefs, argument could be held before the end of the year.

The petition for certiorari is found in *U.S. v. Miller*, 23-824 (Sup. Ct.).

Prior Terms

The opinion by Justice Barrett largely bases the outcome on the use of the passive voice in Section 523(a)(2)(A).

Debts for a Partner's Fraud Are Still Nondischargeable, the Supreme Court Says

Based on the "natural breadth of the passive voice" used in Section 523(a)(2)(A), the Supreme Court held yesterday in a unanimous opinion by Justice Amy Coney Barrett that a partner who herself was innocent of fraud is nonetheless saddled with a nondischargeable debt resulting from the fraud of her partner.

The opinion is a reaffirmation of the Court's holding in *Strang v. Bradner*, 114 U.S. 555 (1885).

In a concurring opinion, Justices Sonia Sotomayor and Ketanji Brown Jackson endeavored to limit the scope of the holding by saying that they understood the outcome to be based on the existence of a partnership under state law.

The Partner's Fraud

Before marrying, a couple formed a partnership to buy, refurbish and sell a home. Judge Barrett said the woman was "largely uninvolved" in the remodel and sale.

Alleging that the disclosure statement failed to list defects in the home, the buyer filed suit after purchasing the home. A jury found the man and woman liable for $200,000 in damages for breach of contract, negligence and nondisclosure of material facts.

The couple filed a chapter 7 petition. The buyer filed an adversary proceeding contending that the judgment was nondischargeable under Section 523(a)(2)(A) as a debt resulting from "false pretenses, a false representation, or actual fraud." After a bench trial, the bankruptcy court ruled that the debt was nondischargeable as to both.

The Bankruptcy Appellate Panel for the Ninth Circuit reversed as to the woman, saying she had no reason to know of the man's fraudulent intent. Relying on *Strang*, the Ninth Circuit reversed the BAP, reinstating the nondischargeability judgment with respect to the woman. According to Justice Barrett, the Court of Appeals reasoned that "a debtor who is liable for her partner's fraud cannot discharge that debt in bankruptcy, regardless of her own culpability."

The woman filed a petition for *certiorari*, which the Court granted to resolve a split among the circuits. The Second, Fourth, Seventh and Eighth Circuits require scienter before the debt is deemed nondischargeable, while the Fifth, Sixth, Ninth and Eleventh Circuits don't.

An Opinion Based on Grammar

Judge Barrett held that the "text" of Section 523(a)(2)(A) barred the woman from discharging the debt "[b]y its terms." Based on the "basic tenets of grammar," she said that the statute's use of the "[p]assive voice pulls the actor off the stage."

Although the debt must result from fraud, Justice Barrett said that "Congress was 'agnosti[c]' about who committed it. *Watson v. United States*, 552 U.S. 74, 81 (2007)." The "context" of the statute, she said, "does not single out the wrongdoer as the relevant actor."

Justice Barrett said that "the common law of fraud . . . has long maintained that fraud liability is not limited to the wrongdoer." Citing a commentator from 1841 and state supreme court decisions from the nineteenth century, she listed courts that "have traditionally held principals liable for the frauds of their agents."

The debtor contended that the interpretation of Section 523(a)(2)(A) should be informed by subsections (B) and (C), which require a culpable act by the debtor. Justice Barrett rejected the argument, saying that the "more likely inference is that (A) excludes debtor culpability from consideration given that (B) and (C) expressly hinge on it."

The Court's Precedent

"Our precedent," Justice Barrett said, "eliminates any possible doubt about our textual analysis."

At the time of *Strang*, the statute required fraud "of the bankrupt." Nonetheless, the Court held in *Strang* that the "fraud of one partner . . . is the fraud of all because '[e]ach partner was the agent and representative of the firm with reference to all business within the scope of the partnership.'" *Strang*, *supra*, 114 U.S. at 561.

Thirteen years after *Strang*, Justice Barrett said that Congress "overhauled the bankruptcy law," this time deleting "'of the bankrupt' from the discharge exception for fraud, which is the predecessor to the modern § 523(a)(2)(A)."

"The unmistakable implication," Justice Barrett said, "is that Congress embraced *Strang*'s holding — so we do too."

Justice Barrett ended her opinion for the Court by saying she was "sensitive to the hardship that the debtor faces," but she went on to say that "innocent people are sometimes held liable for fraud they did not personally commit, and, if they declare bankruptcy, § 523(a)(2)(A) bars discharge of that debt."

The Court affirmed the Ninth Circuit's judgment that the debt was nondischargeable.

The Concurrence

Joined by Justice Jackson, Justice Sotomayor concurred, saying that the "Court correctly holds that 11 U.S.C. § 523(a)(2)(A) bars debtors from discharging a debt obtained by fraud of the debtor's agent or partner." Citing *Strang*, she said that the "Court long ago confirmed that reading when it held that fraudulent debts obtained by partners are not dischargeable."

Justice Sotomayor noted that the woman and her husband incurred the debt after forming a partnership. She said that the "Court here does not confront a situation involving fraud by a person bearing no agency or partnership relationship to the debtor."

She joined the Court's opinion with the "understanding" that it concerns fraud only by "agents" and "partners within the scope of the partnership."

Application to Section 523(a)(19)

Justice Sotomayor's understanding of the opinion, if adopted by other courts, may affect the application of Section 523(a)(19). That subsection bars the discharge of judgments by state or federal courts for violation of state or federal securities laws, but it too is in the passive voice and does not in its language demand a violation committed by the debtor.

Presumably, a court influenced by Justice Sotomayor's concurrence would make a debt nondischargeable as to an innocent debtor only if there were an agency or partnership.

Observations

Justice Barrett rejected the debtor's reliance on *Bullock* v. *BankChampaign, N. A.*, 569 U.S. 267 (2013). There, the Court held that under Section 523(a)(4) the term "defalcation"

> includes a culpable state of mind requirement akin to that which accompanies application of the other terms in the same statutory phrase. We describe that state of mind as one involving knowledge of, or gross recklessness in respect to, the improper nature of the relevant fiduciary behavior.

Id. at 269.

Bullock means that defalcation cannot be derivative, but the Court yesterday held that a fraudulent representation or actual fraud can be derivative.

Curiously, *Strang* cited and discussed *Neal v. Clark*, 95 U.S. 709 (1877). The *Strang* court paraphrased *Neal* as saying that

> the term "fraud," in the clause defining the debts from which a bankrupt is not relieved by a discharge under the bankrupt act, should be construed to mean positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, and not implied fraud or fraud in law, which may exist without the imputation of bad faith or immorality.

Neal required "positive fraud, or fraud in fact," but the Court yesterday imposed nondischargeability when the debt was derived from someone else's fraud.

With respect, this writer sees the Court as being selective in citing nineteenth century precedent for the idea that innocent individuals can be saddled with nondischargeable debts.

True, common law for centuries has held that one partner is liable for another partner's fraud, but nondischargeability and derivative liability for fraud are different questions under a different statute.

However, Congress adopted Section 523(a)(2)(A), presumably knowing what *Strang* says. Still, this writer is troubled by the notion that contemporary courts are so bound by nineteenth century precedent.

The opinion is *Bartenwerfer v. Buckley*, 143 S. Ct. 665, 214 L. Ed. 2d 434 (Sup. Ct. Feb. 22, 2023).

The Supreme Court's MOAC decision contains language casting doubt on the validity of the doctrine of equitable mootness.

Supreme Court Holds: § 363(m) Isn't Jurisdictional; It's a Limitation on Appellate Relief

Reversing the Second Circuit, the Supreme Court handed down a unanimous opinion today in *MOAC Mall Holdings LLC*, deciding that Section 363(m) is not jurisdictional. It's a limitation on the remedy available to an appellate court on an appeal from an order approving a sale.

Section 363(m) says that the reversal or modification "of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease [to a purchaser in good faith] . . . unless such authorization and such sale or lease were stayed pending appeal."

The Second and Fifth Circuits have held that Section 363(m) is jurisdictional. The Third, Sixth, Seventh, Ninth, Tenth and Eleventh Circuits have held that it is not. The opinion for the Court by Justice Ketanji Brown Jackson was her first since her elevation in June 2022.

The Sale of a Sears Lease

The petitioner in the Supreme Court was the landlord of a Sears store in the giant Mall of America. The landlord objected to the assignment of a lease but lost in bankruptcy court.

Initially, the district court reversed the bankruptcy court, holding that a provision in a lease cannot supplant the requirement in Section 365(b)(3)(A) mandating that the financial condition of an assignee of a lease must be "similar to the financial condition . . . of the debtor . . . as of the time the debtor became the lessee under the lease . . . ." *MOAC Mall Holdings LLC v. Transform Holdco LLC (In re Sears Holdings Corp.)*, 613 B.R. 51 (S.D.N.Y. May 11, 2020). ("*MOAC I*"). To read ABI's report on *MOAC I*, click here.

Two weeks later, the purchaser of the lease filed a motion for rehearing. Although having taken contrary positions throughout, the purchaser contended for the first time on rehearing that the appeal should be dismissed under Section 363(m) because the landlord had not obtained a stay pending appeal. Previously, the purchaser had consistently contended that the transaction was not a sale and that Section 363 did not apply.

Ruling on the motion for rehearing, the district judge said that the buyer now "seeks to benefit from a complete reversal of that representation." *MOAC II*, 616 B.R. at 626. Citing *In re WestPoint Stevens Inc.*, 600 F.3d 231, 248 (2d Cir. 2010), and *In re Gucci*, 105 F.3d 837, 838–840 (2d Cir. 1997), the district judge said that the Second Circuit had twice held that Section 363(m) is "a jurisdiction-depriving statute." *Id*. at 624.

In *MOAC II*, the district judge granted rehearing, concluded that she lacked appellate jurisdiction, vacated her earlier opinion, and dismissed the appeal. The Second Circuit affirmed in a nonprecedential opinion. *MOAC Mall Holdings LLC v. Transform Holdco LLC (In re Sears Holdings Corp.)*, 20-1846, 2021 BL 481940, 2021 US App Lexis 37358, 2021 WL 5986997 (2d Cir. Dec. 17, 2021). To read ABI's report on the Second Circuit opinion, click here.

The circuit panel said that the landlord's argument "is foreclosed by our binding precedent in *In re WestPoint Stevens Inc.*, under which § 363(m) deprived the District Court of appellate jurisdiction." In another nonprecedential opinion citing *WestPoint Stevens*, a Second Circuit panel indeed had said that Section 363(m) is jurisdictional because it "creates a rule of statutory mootness." *Pursuit Holdings (NY) LLC v. Piazza (In re Pursuit Holdings (NY) LLC),* 845 Fed. App'x 60, 62 (2d Cir. 2021).

The landlord filed a petition for *certiorari* in March 2022, raising the circuit split. The Court granted the petition at the end of the last term in June 2022.

Jurisdiction Must Be 'Clearly Stated'

Addressing the merits, Justice Jackson rejected the buyer's "creative arguments" and mirrored comments from the district court when she referred to the buyer's conduct as "egregious" in waiting until rehearing in district court to raise the question of jurisdiction.

Justice Jackson's opinion is another stab at repairing the Court's precedents on jurisdiction versus power. She referred to "our past sometimes loose use of the word 'jurisdiction.'" More recently, she said, "We have clarified that jurisdictional rules pertain to 'the power of the court rather than to the rights or obligations of the parties.'"

Today, Justice Jackson said, "we only treat a provision as jurisdictional if Congress 'clearly states' as much," citing *Boechler, P.C. v. Commissioner*, 142 S. Ct. 1493, 1494 (2022). On the other hand, Congress isn't required to use "magic words," she said.

To be jurisdictional, Justice Jackson said that "the statement must indeed be clear; it is insufficient that a jurisdictional reading is 'plausible,' or even 'better,' than nonjurisdictional alternatives," again citing *Boechler*.

Applying precedent, Justice Jackson saw "nothing" in Section 363(m) "that purports to 'gover[n] a court's adjudicatory capacity,'" quoting *Henderson v. Shinseki*, 562 U.S. 428, 435 (2011). To the contrary, she said that "§ 363(m) takes as a given the exercise of judicial power over any authorization under § 363(b) or § 363(c)."

The section, Justice Jackson said, "consists of a caveated constraint on the effect of a reversal or modification" and "is not the stuff of which clear statements are made."

Noting that Section 363(m) is not located in 28 U.S.C. § 1334(a)-(b), (e) and § 157, Justice Jackson said, "Statutory context leads to the same conclusion" that Section 363(m) is not jurisdictional. She said that the buyer "does not (because it cannot) deny the paucity of textual or contextual clues indicating a clear statement of jurisdictional intent."

Justice Jackson said that Section 363(m) is "a mere restriction on the effects of a valid exercise of [appellate] power when a party successfully appeals a covered authorization."

Commentary on Equitable Mootness?

The buyer argued in the Supreme Court that the appeal was moot even without regard to Section 363(m). Justice Jackson rejected the argument using words that might be read as undercutting the validity of the doctrine of equitable mootness, which is the topic of a pending petition for *certiorari*. *See U.S. Bank N.A. v. Windstream Holdings Inc.*, 22-926 (Sup. Ct.).

Without relying on Section 363(m), the buyer argued that the appeal was moot because the transfer of the lease could not now be avoided as a post-petition transaction under Section 549 since the debtor alone had standing to raise Section 549 and the debtor had waived any rights under that section.

In short, the buyer was saying that the appeal was moot because no relief could be granted.

Justice Jackson said that a "'case becomes moot only when it is impossible for a court to grant any effectual relief whatever to the prevailing party,'" quoting *Chafin v. Chafin*, 568 U.S. 165, 172 (2013). "The case remains live," she said, "'[a]s long as the parties have a concrete interest, however small, in the outcome of the litigation.'" *Id.*

In the MOAC appeal, Justice Jackson said, "[W]e cannot say that the parties have 'no "concrete interest,'" *id.* at 176, in whether [the buyer] obtains that relief."

As a court of "first review," Justice Jackson rejected the mootness contention, saying, "[W]e decline to act as a court of 'first view,' plumbing the Code's complex depths in 'the first instance' to assure ourselves that [the buyer] is correct about its contention that no relief remains legally available."

The Court remanded the case to the Second Circuit for "further proceedings consistent with this opinion."

Observations

Today's opinion casts doubt on the doctrine of equitable mootness, where courts routinely dismiss appeals from confirmation orders where the plans have been consummated. *MOAC* could be read to mean that appellate courts should not in the first instance decide that no relief is available following reversal.

MOAC could be read to mean that an appellate court should hear an appeal from a confirmed plan as long as there is constitutional or Article III jurisdiction. More often than not, the appellate court will uphold confirmation and never reach the question of whether there would have been available relief had there been a reversal.

On remand from reversal of confirmation, the bankruptcy court might locate a sliver of relief for the appellant that would not upset the apple cart and undo the plan altogether. Perhaps the bankruptcy court could award attorneys' fees to the creditor who appealed confirmation and established an important principle about chapter 11 plans.

The opinion is *MOAC Mall Holdings LLC v. Transform Holdco LLC*, 22-1270 (Sup. Ct. April 19, 2023).

The high court's ruling on the Takings Clause also seems to mean that real estate tax foreclosures can be avoided as constructively fraudulent transfers.

Supreme Court Holds that Real Estate Tax Foreclosures Can Violate the Takings Clause

Barely one month after oral argument, the Supreme Court unanimously resolved a split of circuits by reversing the Eighth Circuit and holding that a real estate tax foreclosure can violate the Takings Clause of the Fifth Amendment when the municipality takes title but doesn't give the owner the difference between the unpaid taxes and the value of the property.

For the Court, the opinion by Chief Justice John G. Roberts, Jr. said that "[h]istory and precedent" do not permit the state to take away a property interest protected by the Takings Clause.

$40,000 Property Taken for $15,000 in Taxes

A 94-year-old woman had owned a condominium. She went to live in a senior community but did not continue paying real estate taxes on the condominium. When some $2,300 in unpaid real estate taxes accrued along with $13,000 in interest and penalties, the municipality seized the property and sold it for $40,000. The county kept the $25,000 surplus and paid none to the former homeowner.

Conceding the validity of the foreclosure, the homeowner filed a class action under the Takings Clause, challenging the county's retention of the $25,000 surplus. The district court dismissed the suit for failure to state a claim and was affirmed last year in the Eighth Circuit. *Tyler v. Hennepin County*, 26 F.4th 789 (8th Cir. 2022).

The appeals court found no unconstitutional taking because state law recognized no property interest in the owner after the property was seized. The homeowner filed a petition for *certiorari* in May 2022.

While the *certiorari* petition was pending, the Sixth Circuit created a circuit split by holding that a real estate tax foreclosure violated the Takings Clause. *Hall v. Meisner*, 51 F.4th 185 (6th Cir. Oct. 13, 2022). The municipality in *Hall* had taken a $300,000 home in satisfaction of $22,250 in real estate taxes but refused to turn over the surplus. The Sixth Circuit denied a motion for rehearing *en banc* in January. To read ABI's report on *Hall*, click here.

The Supreme Court granted *certiorari* in January and held oral argument on April 26. To read ABI's report on argument, click here.

History and Precedent Rule the Day

The Chief Justice recited the history of real estate tax foreclosure in Minnesota. "Historically," he said, the state recognized an owner's property interest in the excess value in a home sold to satisfy delinquent property taxes. In 1935, he said that "the State purported to extinguish that property interest by enacting a law providing that an owner forfeits her interest in her home when she falls behind on her property taxes."

Against the backdrop of state law, the Chief Justice explored precedent regarding the Takings Clause. Contained in the Fifth Amendment, the clause provides that "private property [shall not] be taken for public use, without just compensation."

The Chief Justice noted that the clause itself "does not define property." He stated the question as "whether that remaining value is property under the Takings Clause, protected from uncompensated appropriation by the State."

The Chief Justice said that state law "is one important source" for defining property rights "but cannot be the only source." Otherwise, he said, the state could "sidestep" the Takings Clause by disavowing traditional property interests. He therefore looked at traditional property law principles "plus historical practice and this Court's precedents."

History

For the "principle that a government may not take more from a taxpayer than she owes," the Chief Justice went back to "Runnymeade in 1215" and found that the principle "became rooted in English law" by acts of Parliament and common law. Then, he said, the principle "made its way across the Atlantic."

Today, the Chief Justice said that the county identified only three states that deem property "entirely forfeited" for delinquent taxes. In contrast, he said that 36 states and the federal government "require that the excess value be returned to the taxpayer."

High Court Precedent

Citing decisions by the Court in 1881 and 1884, the Chief Justice said that "[o]ur precedents have also recognized the principle that a taxpayer is entitled to the surplus in excess of the debt owed." The county, in response, relied on *Nelson* v. *City of New York*, 352 U.S. 103 (1956), where the Court upheld the foreclosure of property for unpaid water bills.

The Chief Justice distinguished *Nelson* by noting how the taxpayer had waived a statutory right to recover the surplus. There was no Takings Clause violation, because the city had not absolutely precluded the owner from recovering the surplus.

The Chief Justice said that Minnesota "itself recognizes that in other contexts a property owner is entitled to the surplus in excess of her debt." For example, he mentioned real estate mortgage foreclosures, where a homeowner is entitled to the surplus after foreclosure.

The Chief Justice reversed the Eighth Circuit, saying that the homeowner "has plausibly alleged a taking under the Fifth Amendment," because the state made "an exception only for itself, and only for taxes on real property." Minnesota, he said, "may not extinguish a property interest that it recognizes everywhere else to avoid paying just compensation when it is the one doing the taking."

The Concurring Opinion

Agreeing there was a "plausibly alleged" violation of the Takings Clause, Justice Neil M. Gorsuch wrote a concurring opinion, joined by Justice Ketanji Brown Jackson. They wrote separately to deal with the Excessive Fines Clause in the Eighth Amendment.

In addition to the Takings Clause, the Eighth Circuit had found no violation of the Excessive Fines Clause. The Chief Justice did not address the Eighth Amendment, because the homeowner said that the finding of a Takings Clause violation would fully remedy her harm.

Justices Gorsuch and Jackson concurred because, they said, "even a cursory review" of the circuit's decision "reveals that it too contains mistakes future lower courts should not be quick to emulate."

The Eighth Circuit saw no Eighth Amendment violation, because they believed the statute to be remedial. Justice Gorsuch said, "It matters not whether the scheme has a remedial purpose, even a predominantly remedial purpose." The Excessive Fines Clause does not apply only when the statute is solely remedial.

According to Justice Gorsuch, the district also found no Eighth Amendment violation because the statute was not punitive, since it did not turn on culpability. He said that a statute may still be punitive if it uses punishment as a deterrent.

Justice Gorsuch ended his concurrence by saying:

> Economic penalties imposed to deter willful noncompliance with the law are fines by any other name. And the Constitution has something to say about them: They cannot be excessive.

Observations

The finding of a constitutional right to the surplus in a tax foreclosure may put a related issue to rest: Can a tax foreclosure be attacked in bankruptcy as a fraudulent transfer?

In *BFP v. Resolution Trust*, 511 U.S. 531 (1994), the Supreme Court held that regularly conducted real estate mortgage foreclosures cannot be fraudulent transfers, no matter how much equity the debtor loses above the mortgage debt.

The Fifth, Ninth and Tenth Circuits expanded *BFP* by holding that real estate tax foreclosures cannot be avoided as fraudulent transfers. The most recent of those decisions came from the Ninth Circuit. *See Tracht Gut, LLC v. Los Angeles County Treasurer*, 836 F.3d 1146 (9th Cir. 2016). To read ABI's report on *Tracht Gut*, click here.

The Second, Third, Sixth and Seventh Circuits have held that real estate tax foreclosures can be attacked as fraudulent transfers. To read ABI's reports, click here, here, here and here.

Since a tax foreclosure can violate the Constitution, it stands to reason that a tax foreclosure can be avoided as a fraudulent transfer.

Granted, the standards for finding a constitutional violation and a constructively fraudulent transfer are different. Given that courts will not rule on constitutional questions when the same result can be reached by other means, this writer believes that courts in the future will examine real estate tax forecloses to find fraudulent transfers before turning to the Constitution.

This writer bases his belief on the holding by the Chief Justice that a homeowner has a constitutionally protected property interest in the surplus arising from a tax foreclosure.

Indeed, one could ask whether *BFP* can be reconciled with *Tyler*. If the surplus in foreclosure is constitutionally protected property, how can a real estate tax foreclosure pass muster no matter how much equity the owner loses in foreclosure?

The opinion is *Tyler v. Hennepin County*, 22-166 (Sup. Ct. May 25, 2023).

The Supreme Court resolved a split of circuits in an opinion that could give support to the notion that arbitration agreements are not enforceable in bankruptcy.

Supreme Court: The Bankruptcy Code Waived Tribes' Sovereign Immunity

Over a dissent by Justice Neil M. Gorsuch, Justice Ketanji Brown Jackson held for herself and six other justices that Section 106(a) of the Bankruptcy Code waives sovereign immunity as to tribes of Native Americans.

Justice Clarence Thomas concurred in the judgment, believing that tribes never had sovereign immunity to begin with.

Compelling Facts for the Debtor

The debtor borrowed $1,100 from a corporate payday lender before filing bankruptcy. The lender was owned by a federally recognized tribe. By the time the debtor filed a chapter 13 petition, the debt had grown to almost $1,600 as an unsecured, nonpriority claim.

Despite the automatic stay and despite being told about the bankruptcy, the tribal lender continually called the debtor demanding payment. Two months after bankruptcy, the debtor attempted suicide, blaming his action on the incessant calls.

In bankruptcy court, the debtor sought an injunction to halt collections attempts, along with damages and attorneys' fees. The bankruptcy court granted the tribe's motion to dismiss, based on sovereign immunity. The First Circuit accepted a direct appeal and reversed over a vigorous dissent.

For the majority, First Circuit Judge Sandra L. Lynch took sides with the Ninth Circuit, which had held in 2004 that Section 106(a) abrogated sovereign immunity for tribes. *Krystal Energy Co. v. Navajo Nation*, 357 F.3d 1055, 1061 (9th Cir. 2004). She disagreed with the Sixth Circuit, which found no waiver in 2019. *In re Greektown Holdings, LLC*, 917 F.3d 451, 460- 61 (6th Cir. 2019), *cert. dismissed sub nom. Buchwald Cap. Advisors LLC v. Sault Ste. Marie Tribe*, 140 S. Ct. 2638 (2020). While the *certiorari* petition was pending in *Greektown*, the case settled, and the petition was dismissed. To read ABI's report on *Greektown*, click here.

The debtor in the First Circuit filed a petition for *certiorari*, which the Court granted in September. Oral argument was held in January. To read ABI's report on argument, click here.

The Majority's Rationale

Justice Jackson began her June 15 opinion by laying out the law on waivers of sovereign immunity. Congressional intent to waive immunity must be made in "unequivocal terms." Although the Court does not oblige Congress to use "magic words," the intent to waive must be "unmistakably clear" or "clearly discernable" from the statute.

The circuits were split because the statute arguably leaves something to be desired. For "governmental units," Section 106(a) waives sovereign immunity as to a long list of sections in the Bankruptcy Code. The Section 362 automatic stay is on the list.

Section 101(27) defines "governmental unit." Regarding waiver as to tribes, the question for the Supreme Court was whether tribes come under the rubric of "other foreign or domestic government," as used in Section 101(27).

Justice Jackson did not leave the reader in doubt. After laying out general law, she said:

> [T]he Bankruptcy Code unequivocally abrogates the sovereign immunity of any and every government that possesses the power to assert such immunity. Federally recognized tribes undeniably fit that description; therefore, the Code's abrogation provision plainly applies to them as well.

To justify the conclusion, Justice Jackson wrote a 16-page opinion, one page shorter than the dissent. She said that the statutory "definition of 'governmental unit' exudes comprehensiveness from beginning to end." By "coupling foreign and domestic together, and placing the pair at the end of an extensive list, Congress unmistakably intended to cover all governments in §101(27)'s definition, whatever their location, nature, or type," she said.

Justice Jackson found reinforcement in other aspects of the Bankruptcy Code, such as the application of the Code's "requirements generally . . . to all creditors. "

Finding no "indication" that Congress "categorically" excluded "certain governments" from the Code's "enforcement mechanisms and exceptions," Judge Jackson identified the "one remaining question" as whether federally recognized tribes "qualify as governments."

Justice Jackson said that Congress "repeatedly characterizes tribes as governments." Given that the "Code unequivocally abrogates the sovereign immunity of all governments, categorically," and that "Tribes are indisputably governments," she held that "§106(a) unmistakably abrogates their sovereign immunity too."

The Tribe's Arguments Rejected

Justice Jackson devoted the final six pages of her opinion to rebutting the tribe's arguments, such as the fact that every other case finding a waiver involved a statute that specifically mentioned tribes.

Justice Jackson said that "the universe of cases . . . is exceedingly slim," and the fact that Congress had mentioned tribes specifically "does not foreclose it from using different language to accomplish that same goal in other statutory contexts."

Justice Jackson addressed the dissent by Justice Gorsuch, who described tribes as a "hybrid" that is neither "foreign" nor "domestic." She found it "hard to see why the Code would subject purely foreign or domestic governments to enforcement proceedings while at the same time immunizing government creditors that have both foreign and domestic attributes."

Finally, Justice Jackson said that the definition of "governmental unit" is "undeniably broader" in the Bankruptcy Code than it was under the former Bankruptcy Act. "[H]owever Congress may have treated governmental entities in bankruptcy law prior to 1978," she said, "it had clearly altered its view about the scope of coverage relative to governments by the time it enacted §101(27) and §106(a)."

Justice Jackson affirmed the First Circuit.

The Concurrence

Justice Thomas concurred in the judgment, but on entirely different grounds. He said that "the Court should simply abandon its judicially created tribal sovereign immunity doctrine."

Citing his own dissent in a prior case, Justice Thomas said that tribal sovereign immunity was not mandated by the Constitution but was a common law doctrine. "Because no federal law accords tribes sovereign immunity in federal court," he said, the tribe "lack[s] immunity in this federal case."

Furthermore, Justice Thomas said that governments protected by sovereign immunity have no protection for their "commercial acts."

"Accordingly," Justice Thomas said, "any common-law immunity that [the tribe] possess[es] cannot support [its] claim to immunity in federal court for their off-reservation commercial conduct."

The Dissent by Justice Gorsuch

Justice Gorsuch opened his 17-page dissent by saying that tribes were specifically mentioned in the statute every time the Court has previously found a waiver of sovereign immunity. Although the majority's interpretation was "plausible," he said that "plausible is not the standard our tribal immunity jurisprudence demands."

From "two centuries of history and precedent," Justice Gorsuch said, "Tribes [have enjoyed] a unique status in our law," meaning that they are neither "foreign" nor "domestic." Because the Bankruptcy Code does not refer to tribes specifically, he found no waiver.

Justice Gorsuch addressed the majority's notion that the Bankruptcy Code "exudes comprehensiveness." He said it's "true but not obviously helpful," because the Court has never "held that a statute's general atmospherics can satisfy the clear-statement rule when the text itself comes up short."

Quoting his own concurrence in a case last term, Justice Gorsuch "respectfully" dissented because Congress cannot use "oblique or elliptical language."

Observations

Policy arguments typically gain little or no traction in textualist decisions by the Supreme Court.

It is therefore noteworthy that Justice Jackson found support for her conclusion in "[o]ther aspects of the Bankruptcy Code" and "the Code's 'orderly and centralized' debt-resolution process," which, she said, "generally apply to *all* creditors." [Emphasis in original.]

At least when it comes to decisions involving the Bankruptcy Code, the Supreme Court might be amenable to interpreting a confusing provision in light of the larger principles undergirding the Code.

If a case one day asks the Supreme Court to decide whether arbitration agreements are enforceable in bankruptcy, the statement by Justice Jackson that the Code's provisions "generally apply to *all* creditors" suggests that arbitration agreements are unenforceable in bankruptcy, given the Code's "orderly and centralized" processes.

The opinion is *Lac du Flambeau Band of Lake Superior Chippewa Indians v. Coughlin,* 22-227 (Sup. Ct. June 15, 2023).

Split 5/4, the Supreme Court rules that denial of a motion to compel arbitration automatically imposes a stay pending appeal.

A Supreme Court Arbitration Opinion Could Disrupt Bankruptcies

A 5/4 arbitration decision by the Supreme Court on June 23 in a nonbankruptcy case could disrupt bankruptcies large and small.

In *Coinbase Inc. v. Bielski*, the Supreme Court held that denial of a motion to compel arbitration automatically imposes a stay on the entire action in the trial court, pending appeal from the order denying arbitration.

If *Coinbase* applies in bankruptcy cases, the bankruptcy court would at a minimum be automatically enjoined from deciding issues involving a creditor that unsuccessfully called for arbitration.

The four dissenters in the Supreme Court likened the majority's opinion to opening "Pandora's box." Disruption of bankruptcy cases may be one of the unintended, unanticipated effects to emerge from *Coinbase*. Application of *Coinbase Inc.* to chapter 11 cases may impel the Supreme Court to decide whether or not arbitration clauses are generally unenforceable in bankruptcy cases.

The Facts and the Circuit Split

A customer filed a putative class action in federal district court against an online platform for buying and selling cryptocurrencies. The complaint alleged that the platform failed to replace funds taken fraudulently from accounts.

The platform filed a motion to compel arbitration, based on an arbitration clause contained in the user agreement. The district court denied the arbitration motion.

Citing 9 U.S.C. § 16(a), the platform filed an interlocutory appeal. As Justice Brett M. Kavanaugh said in his majority opinion for the Court, "Section 16(a) authorizes an interlocutory appeal from the denial of a motion to compel arbitration."

The platform moved in district court for a stay pending appeal. The district court denied the stay, as did the Ninth Circuit. To resolve a split of circuits on whether stays pending appeal are

automatic following denial of an arbitration motion, the Supreme Court granted *certiorari* and heard argument on March 21.

The Majority Opinion

Justice Kavanaugh said that Section 16(a) contains "a rare statutory exception to the usual rule" that appeals are not taken from interlocutory orders. He also said that the section "does not say whether the district court proceedings must be stayed."

Finding an automatic stay, Justice Kavanaugh based his conclusion on a statement in *Griggs* v. *Provident Consumer Discount Co.*, 459 U.S. 56, 58 (1982), that an appeal "'divests the district court of its control over those aspects of the case involved in the appeal.'"

Justice Kavanaugh reasoned that "the entire case is essentially 'involved in the appeal,'" citing *Griggs, id*. Citing the Seventh Circuit, he said that whether the case may go ahead in district court is precisely the issue on appeal. Also citing the Seventh Circuit, he said it makes no sense to proceed in district court while the appeals court decides whether there should be a case in district court at all.

"In short," Justice Kavanaugh said, "*Griggs* dictates that the district court must stay its proceedings while the interlocutory appeal on arbitrability is ongoing." Saying that most courts impose a stay automatically, he said that "common practice makes common sense."

Dismissing five arguments advanced by the plaintiff, Justice Kavanaugh said that the benefits of arbitration could be "irretrievably lost" were the action to proceed in the trial court pending appeal.

The Dissenters

Justice Ketanji Brown Jackson dissented, joined by Justices Sonia Sotomayor and Elena Kagan. Justice Clarence Thomas joined in most of Justice Jackson's dissent.

Justice Jackson said that the majority "departs from the traditional approach" by imposing "a mandatory stay of trial court proceedings." The mandatory stay rule, she said, "comes out of nowhere" and "perpetually favor[s] one class of litigants."

Justice Jackson saw no mandatory stay rule in Section 16(a). Indeed, she said that the section "never even mentions a stay pending appeal."

Rather than justifying an automatic stay, Justice Jackson said that *Griggs* "expresses a far narrower principle" that two courts "should avoid exercising control over the same order or judgment simultaneously." To her way of thinking, "*Griggs* divests the district court of control over

only a narrow slice of the case," namely, the ability to modify the order refusing to compel arbitration.

On appeals, Justice Jackson said that only arbitrability was before the appellate court, "not the merits."

Justice Jackson began the last two pages of her 15-page opinion by saying that the majority "ventures down an uncharted path — and that way lies madness." She said that a "wide array of appeals seemingly fits the bill."

An "appeal over the proper forum for a dispute" or "all appeals over forum-selection agreements" would "arguably raise the same question," just like orders granting preliminary injunctions, Justice Jackson said. "Taken that broadly," she warned, "the mandatory-general-stay rule the Court adopts today would upend federal litigation as we know it."

Justice Jackson ended her dissent by saying that the "mandatory-general-stay rule that the Court manufactures is unmoored from Congress's commands and this Court's precedent."

Observations

The Supreme Court has yet to decide where or to what extent arbitration clauses are enforceable in bankruptcy. Is arbitration always prohibited, or only when the dispute falls within the bankruptcy court's "core" jurisdiction?

The majority opinion does not limit the automatic stay rule to particular sorts of cases. Presumably, it also applies in bankruptcy.

Suppose a creditor's agreement with the debtor contains a broadly worded arbitration clause. What if the debtor objects to the creditor's claim, the creditor invokes the arbitration agreement, and the bankruptcy court denies the motion to compel arbitration? Is the objection to claim automatically stayed pending appeal to the district court, the circuit court and the Supreme Court?

Or, what about the question of whether a creditor with an arbitration agreement is impaired by a chapter 11 plan? Or, what if the creditor claims that the plan is not fair and equitable? Are the proceedings in bankruptcy court automatically enjoined until there is a final order declining to compel arbitration?

Compelling arbitration in bankruptcy cases could stall chapter 11 cases. Depending on the nature of the issue, a *Coinbase* automatic stay pending appeal could delay, disrupt or torpedo a reorganization.

The opinion is *Coinbase Inc. v. Bielski*, 22-105 (Sup. Ct. June 23, 2023).

The Supreme Court ducked the question of whether Puerto Rico and other U.S. territories are entitled to Eleventh Amendment sovereign immunity just like states.

Supreme Court Holds that PROMESA Didn't Waive Puerto Rico's Sovereign Immunity

Over a dissent by Justice Clarence Thomas, the Supreme Court *assumed* that Puerto Rico and the Financial Oversight and Management Board are entitled to sovereign immunity like a state. In her opinion of the Court on May 11, Justice Elena Kagan reversed the First Circuit by holding that nothing in the Puerto Rico Oversight, Management, and Economic Stability Act, or PROMESA (48 U.S.C. §§ 2161 *et. seq.*), waived the Oversight Board's sovereign immunity.

The Origins of PROMESA and the Board

After the Supreme Court ruled that Puerto Rico was ineligible for municipal bankruptcy in chapter 9 of the Bankruptcy Code, Congress quickly enacted PROMESA, which adopts large portions of chapter 9. Puerto Rico and many of its instrumentalities sought relief under PROMESA in 2017 in what is known as Title III debt-adjustment proceedings.

In the Title III proceedings, Puerto Rico's federally appointed Financial Oversight and Management Board in substance represented Puerto Rico and its instrumentalities. In April 2022, the First Circuit upheld confirmation of the Oversight Board's plan of adjustment for the Commonwealth of Puerto Rico. To read ABI's report, click here.

In 2017 and again in 2019, nonprofit media organizations filed suit in federal district court in Puerto Rico, asking the PROMESA court to compel the Oversight Board to disclose broad categories of information and communications regarding the proceedings. The Board filed a motion to dismiss based on Eleventh Amendment sovereign immunity, among other things.

The district court denied the motion to dismiss and ordered the production of documents and other information. The district court reasoned that the Board was entitled to sovereign immunity but that Section 106 of PROMESA had waived and abrogated immunity.

The Board appealed.

First Circuit Finds a Waiver of Immunity

The First Circuit had previously held that Puerto Rico and the Oversight Board were entitled to sovereign immunity. Therefore, the First Circuit only considered on appeal whether PROMESA had waived sovereign immunity as to the suit by the news organization.

Finding a waiver of sovereign immunity, the majority on the First Circuit panel principally relied on Section 106 of PROMESA, which says that "any action against the . . . Board, [or] . . . otherwise arising out of [PROMESA] . . . shall be brought in [the district court for the district of Puerto Rico]." 48 U.S.C. § 2126(a).

By the inclusion of Section 106, the First Circuit majority reasoned that "Congress unequivocally stated its intention that the Board could be sued for 'any action . . . arising out of [PROMESA],' but only in federal court. Congress was unmistakably clear that it had contemplated remedies for constitutional violations and that injunctive or declaratory relief against the Board may be granted." *Financial Oversight & Management Board for Puerto Rico v. Centro de Periodismo Investigativo Inc.*, 35 F.4th 1, 17 (1st Cir. May 17, 2022). To read ABI's story, click here.

The majority on the appeals court panel affirmed the district court's order denying the motion to dismiss, finding a waiver of sovereign immunity.

In dissent, Circuit Judge O. Rogeriee Thompson found "[a]bsolutely nothing in the text of [Section 106 that] sets forth an intent to abrogate Eleventh Amendment immunity." *Id*. at 21. Announcing a theme that later persuaded Justice Kagan, Judge Thompson said that the "Supreme Court has repeatedly held that jurisdiction-granting clauses like § 106 do not abrogate Eleventh Amendment immunity. [Footnote omitted.]" *Id*. at 22.

Believing there was no abrogation of sovereign immunity, Judge Thompson "respectfully" dissented, ending her opinion by saying that "today's decision should not go uncorrected." *Id*. at 25.

The Oversight Board filed a petition for *certiorari* in July 2022. The petition stated the question presented as whether Section 106 of PROMESA abrogated the Oversight Board's sovereign immunity. The Court granted the petition in October. Argument was held in January.

The Opinion of the Court

Justice Kagan restated the question presented as "whether [PROMESA] categorically abrogates (legalspeak for eliminates) any sovereign immunity the board enjoys from legal claims."

Telling the reader in the first paragraph that she was reversing, Justice Kagan said:

> Under long-settled law, Congress must use unmistakable language to abrogate sovereign immunity. Nothing in the statute creating the Board meets that high bar.

Justice Kagan found nothing "explicit" in PROMESA about the abrogation of sovereign immunity except for Title III cases. "In particular," she said, "no provision states that it is abrogating any immunity the Board possesses from legal claims."

"At the same time," Justice Kagan said, "several provisions of PROMESA contemplate that, even outside the Title III context, the Board may confront legal claims against it."

Justice Kagan found only two circumstances where Congress has issued an "unequivocal declaration" abrogating immunity. The first is when the statute "says in so many words that it is stripping immunity." The second "is when a statute creates a cause of action and authorizes suit against a government on that claim."

"PROMESA fits neither of those molds," Justice Kagan said.

Reversing the First Circuit and remanding, Justice Kagan held:

> In short, nothing in PROMESA makes Congress's intent to abrogate the Board's sovereign immunity "unmistakably clear." *Kimel*, 528 U.S., at 73. The statute does not explicitly strip the Board of immunity. It does not expressly authorize the bringing of claims against the Board. And its judicial review provisions and liability protections are compatible with the Board's generally retaining sovereign immunity.

The Dissent by Justice Thomas

Justice Kagan said that the First Circuit and the district court "simply assumed the Board's immunity before turning to the abrogation issue."

"We took the case on those terms, and we resolve it on those terms," Justice Kagan said. "That means we assume without deciding that Puerto Rico is immune from suit in federal district court, and that the Board partakes of that immunity."

Justice Thomas would have affirmed the First Circuit, but on the very ground that the majority assumed without deciding.

Justice Thomas explained how the Oversight Board claimed sovereign immunity under the Eleventh Amendment. He paraphrased the amendment to mean that "the Constitution does not allow federal or state courts to hear cases against States without their consent."

Working from the proposition that Puerto Rico is a territory and not a state, Justice Thomas said it "is difficult to see how the same inherent sovereign immunity that the States enjoy in federal court would apply to Puerto Rico." He said that the Oversight Board's argument for Eleventh Amendment immunity was "untenable."

Justice Thomas would have affirmed because he believes that the Oversight Board had not established its immunity.

Observations

For Puerto Rico, the case is notable in that the majority ducked the question of whether territories are entitled to sovereign immunity. If the question is ever presented to the Court, the dissent means that Justice Thomas would see no constitutional immunity for territories because they are not states. How he would feel about tribes of Native Americans is less clear.

Indeed, tribal sovereign immunity is *sub judice* in the Supreme Court in *Lac du Flambeau Band of Lake Superior Chippewa Indians v. Coughlin,* 22-227 (Sup. Ct.). The case was argued on April 24. Similar to the PROMESA case, the First Circuit had deepened an existing circuit split by holding over a lengthy dissent in *Lac du Flambeau* that Sections 106(a) and 101(27) of the Bankruptcy Code waived sovereign immunity as to Native American tribes. To read ABI's report on oral argument, click here.

The PROMESA decision doesn't indicate how the Court will decide *Lac du Flambeau*, except to say that "abrogation requires an 'unequivocal declaration' from Congress." Presumably, the decision in *Lac du Flambeau* will tell us whether "other foreign or domestic government" in Section 101(27) is an unequivocal reference to tribes that waives immunity.

It's a good bet, however, that Justice Kagan will write the opinion in *Lac du Flambeau*.

The opinion is *Financial Oversight & Management Board for Puerto Rico v. Centro de Periodismo Investigativo Inc.*, 22-96 (Sup. Ct. May 11, 2023).

The Supreme Court's unanimous opinion avoids saying whether the dual system of U.S. Trustees and Bankruptcy Administrators is itself unconstitutional.

2018 Increase in U.S. Trustee Fees Held Unconstitutional by the Supreme Court

The Supreme Court ruled unanimously on June 6 that the increase in fees payable to the U.S. Trustee system in 2018 violated the uniformity aspect of the Bankruptcy Clause of the Constitution because it was not immediately applicable in the two states with Bankruptcy Administrators rather than U.S. Trustees.

The opinion for the Court by Justice Sonia Sotomayor said that the Uniformity Clause "is not a straightjacket: Congress retains flexibility to craft legislation that responds to different regional circumstances that arise in the bankruptcy system." She remanded for lower courts to determine the proper remedy.

Although Justice Sotomayor pointedly said that her opinion "does not today address the constitutionality of the dual scheme of the bankruptcy system itself," some of her language could be read to imply that the dual system is constitutionally questionable.

The Fee Structure's History

Justice Sotomayor recounted how U.S. Trustees were originally a pilot program after the adoption of the Bankruptcy Code in 1978. In 1986, Congress expanded the program nationwide, but not in North Carolina and Alabama, where she said there was "resistance from stakeholders." Courts in those states retained their Bankruptcy Administrators.

The U.S. Trustee system was designed to be self-funding, with fees paid by chapter 11 debtors in 48 states. Originally, Congress did not require user fees in the two exempted states. After the Ninth Circuit held in 1995 that the dual system was unconstitutional in view of the disparate fees, Congress rewrote the law to say that the Judicial Conference "may" requires fees in Bankruptcy Administrator districts to be equal to those in the other 48 states.

Fees in all states were the same until Congress raised the fees in January 2018 for the U.S. Trustee system. Justice Sotomayor said the increase was "significant."

The Judicial Conference did raise the fees in the two other states effective in October 2018. There were two differences, Justice Sotomayor said.

First, the increase was not effective in the two states until October 2018, while the U.S. Trustee fees had risen everywhere else in January 2018. Second, the increase in the two states only applied to newly filed cases. In U.S. Trustee districts, the increase applied to pending cases, not only new cases.

Procedural History

Circuit City Stores Inc., the debtor that brought the case to the Supreme Court, had confirmed a chapter 11 plan in 2010. Until the increase went into effect, the debtor had been paying $30,000 a quarter, the maximum.

In the period after the increase, the debtor paid $632,500 in fees. Had there been no increase, Justice Sotomayor said the fees during the period would have been only $56,400.

The debtor mounted an objection to the increase on constitutional grounds and won. Bankruptcy Judge Kevin R. Huennekens of Richmond, Va., held that the increased fees violated the Uniformity Clause, if the fee is seen as a tax, and violated the Bankruptcy Clause, if the fee is considered a user fee. *In re Circuit City Stores Inc.*, 606 B.R. 260 (Bankr. E.D. Va. July 15, 2019). To read ABI's report, click here.

However, the bankruptcy court did not rule on whether the debtor was entitled to a refund, Justice Sotomayor said.

The Fourth Circuit agreed to hear an interlocutory appeal and reversed in a 2/1 decision. The majority on the Richmond, Va.-based appeals court did not believe that the increase was arbitrary. The dissenter would have held the increase to be unconstitutional. *In re Circuit City Stores, Inc.*, 996 F.3d 156 (4th Cir. April 29, 2021). To read ABI's report, click here.

Like the Fourth Circuit, the Fifth Circuit saw no constitutional infirmity. There were dissenters in both opinions. In unanimous opinions, the Second and Tenth Circuits found constitutional transgressions. The Supreme Court granted *certiorari* to resolve the circuit split and heard oral argument on April 18.

Applicability of the Bankruptcy Clause

The Bankruptcy Clause empowers Congress to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."

Defending the disparate fee structure, the U.S. Solicitor General argued that the fees were not covered by the Bankruptcy Clause because the fee statutes were not substantive law.

The language of the clause is "broad," Justice Sotomayor said, and "[n]othing in the language of the Bankruptcy Clause itself, however, suggests a distinction between substantive and administrative laws." Furthermore, she said that the Court has never "distinguished between substantive and administrative bankruptcy laws or suggested that the uniformity requirement would not apply to both."

"Not surprisingly," Justice Sotomayor said, all courts to consider the question have concluded that the fees were subject to the Bankruptcy Clause, including those courts that found no constitutional violation.

"Moreover," Justice Sotomayor said, the fees were substantive because they affected the debtor/creditor relationship by making less money available for creditors in 48 states. She said that Congress exempted debtors from the higher fees in two states "without identifying any material difference between debtors across those States."

Precedent Foretells the Outcome

Having decided that the fee structure was subject to the Bankruptcy Clause, Justice Sotomayor addressed the question of whether the disparate fees were "a permissible exercise of that Clause." She discussed the three Supreme Court cases that have confronted the meaning of the clause. "Taken together," she said, "they stand for the proposition that the Bankruptcy Clause offers Congress flexibility, but does not permit arbitrary geographically disparate treatment of debtors."

In 1908 under the former Bankruptcy Act, Justice Sotomayor said that the Supreme Court upheld the constitutionality of state homestead and exemption laws, because the general operation of the law was uniform, although the results might be different in some states. *Hanover Nat. Bank v. Moyses*, 186 U.S. 181, 187 (1902).

In 1974, the Court upheld a railroad reorganization law that only applied to railroads in the Northeast and Midwest. Based on the "flexibility" in the Bankruptcy Clause, the Court upheld the law that addressed "geographically isolated problems." *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 159 (1974)."

Justice Sotomayor read *Regional Rail Reorganization Act Cases* to mean that "Congress may enact geographically limited bankruptcy laws consistent with the uniformity requirement if it is responding to a geographically limited problem."

In *Railway Labor Executives' Assn. v. Gibbons*, 455 U.S. 457 (1982), the Court struck down a railroad reorganization law than changed the priority scheme, but only for one railroad.

From the three cases, Justice Sotomayor said that the Bankruptcy Clause "does not give Congress free rein to subject similarly situated debtors in different States to different fees because it chooses to pay the costs for some, but not others."

In other words, the clause permits "flexibility, but does not permit arbitrary geographically disparate treatment of debtors," Justice Sotomayor said.

Impermissible Lack of Uniformity

For Justice Sotomayor, the "only remaining question" was "whether Congress permissibly imposed nonuniform fees because it was responding to a funding deficit limited to the Trustee Program districts."

In the case in the Supreme Court, the geographical discrepancy cost Circuit City more than $500,000, Justice Sotomayor said. She said that the budgetary shortfall in the U.S. Trustee districts:

> existed only because Congress itself had arbitrarily separated the districts into two different systems with different cost funding mechanisms, requiring Trustee Program districts to fund the Program through user fees while enabling Administrator Program districts to draw on taxpayer funds by way of the Judiciary's general budget.

The reasons for the different fees, Justice Sotomayor said, "stem not from an external and geographically isolated need, but from Congress' own decision to create a dual bankruptcy system funded through different mechanisms in which only districts in two States could opt into the more favorable fee system for debtors."

Consequently, Justice Sotomayor held that "the Clause does not permit Congress to treat identical debtors differently based on an artificial funding distinction that Congress itself created."

Final Comments by Justice Sotomayor

The debtor took the position in the Supreme Court that the dual system itself is unconstitutional. Justice Sotomayor said that the Court was not addressing "the constitutionality of the dual scheme of the bankruptcy system itself."

Indicating that the Court was not overruling the *Regional Rail Reorganization Act Cases*, Justice Sotomayor said the opinion "should not be understood to impair Congress' authority to structure relief differently for different classes of debtors or to respond to geographically isolated problems." Rather, she said that the court was only prohibiting "Congress from arbitrarily burdening only one set of debtors with a more onerous funding mechanism than that which applies to debtors in other States."

Justice Sotomayor ended her opinion by noting how the government and the debtor disagreed about the remedy in the event of reversal. Because the Fourth Circuit had not considered remedy, she reversed and remanded for the Fourth Circuit to consider remedy "in the first instance."

Is the Dual System Constitutionally Sound?

In the context of disparate fees, Justice Sotomayor noted how the Ninth Circuit said that the dual system of U.S. Trustees and Bankruptcy Administrators was unconstitutional. *St. Angelo v. Victoria Farms, Inc.*, 38 F.3d 1525 (1994), *amended*, 46 F.3d 969 (1995). The question never went to the Supreme Court because Congress quickly brought the fees in line.

Litigants may have difficulty attacking the dual system on appeal given the requirement of showing actual pecuniary harm. Furthermore, does the Constitution mandate that all debtors have the same adversary? And if all debtors must have the same adversary, are court-appointed trustees constitutional in chapters 7 and 13? In other words, overturning the dual system would have wide ramifications.

Several statements by Justice Sotomayor might bear on the constitutionality of the dual system. Early in the opinion, she said that "Congress itself had arbitrarily separated the districts into two different systems." She also said that Congress may "enact geographically limited bankruptcy laws consistent with the uniformity requirement in response to a geographically limited problem."

Is the dual system unconstitutional simply because it is arbitrary? Is the dual system unconstitutional just because there was no geographical mandate? Laws are not unconstitutional just because they are arbitrary.

Although the constitutionality of the dual system is unclear, this writer believes that the system is subject to scrutiny under the Bankruptcy Clause, because Justice Sotomayor several times said the clause must be brought to bear whether the law is substantive or "administrative."

Although the disparate fees are ancient history, the last chapter has not been written. Absent settlement, the lower courts in the *Circuit City* case can decide on remand whether the debtor is entitled to a refund.

The same issue is alive in a now-revived class action that could end up giving refunds to chapter 11 debtors throughout the country that paid higher fees.

The Federal Court of Claims dismissed a class action on ruling that the disparate fees did not violate the Bankruptcy Clause. *See Acadiana Management Group LLC v. U.S.*, 19-496, 151 Fed. Cl. 121 (Ct. Cl. Nov. 30, 2020).

The debtor-plaintiff appealed and is asking the Federal Circuit to reinstate the class action. Oral argument in the Federal Circuit was postponed pending the outcome in *Circuit City*. For ABI's report on *Acadiana*, click here.

The opinion is *Siegel v. Fitzgerald*, 21-441 (Sup. Ct. June 6, 2022).

Justices rule that affirmative action is required before withholding property amounts to controlling estate property and results in an automatic stay violation.

Supreme Court Holds that Merely Holding Property Isn't a Stay Violation

Reversing the Seventh Circuit and resolving a split among the circuits, the Supreme Court ruled unanimously today "that mere retention of property does not violate the [automatic stay in] § 362(a)(3)."

Writing for the 8/0 Court in a seven-page opinion, Justice Samuel A. Alito, Jr. said that Section 362(a)(3) "prohibits affirmative acts that would disturb the *status quo* of estate property." He left the door open for a debtor to obtain somewhat similar relief under the turnover provisions of Section 542, although not so quickly.

In a concurring opinion, Justice Sonia Sotomayor wrote separately to explain how a debtor may obtain the same or similar relief under other provisions of the Bankruptcy Code.

Justice Amy Coney Barrett, who had not been appointed when argument was held on October 13, did not take part in the consideration and decision of the case.

The Chicago Parking Ticket Cases

Four cases went to the Seventh Circuit together. The chapter 13 debtors owed between $4,000 and $20,000 in unpaid parking fines. Before bankruptcy, the city had impounded their cars. Absent bankruptcy, the city will not release impounded cars unless fines are paid.

After filing their chapter 13 petitions, the debtors demanded the return of their autos. The city refused to release the cars unless the fines and other charges were paid in full.

The debtors mounted contempt proceedings in which four different bankruptcy judges held that the city was violating the automatic stay by refusing to return the autos. After being held in contempt, the city returned the cars but appealed.

The Seventh Circuit upheld the bankruptcy courts, holding "that the City violated the automatic stay . . . by retaining possession . . . after [the debtors] declared bankruptcy." The city, the appeals court said, "was not passively abiding by the bankruptcy rules but actively resisting Section 542(a)

to exercise control over the debtors' vehicles." *In re Fulton*, 926 F.3d 916 (7th Cir. June 19, 2019). To read ABI's report on the *Fulton* decision in the circuit court, click here.

The Circuit Split

The Second, Seventh, Eighth, Ninth and Eleventh Circuits impose an affirmative duty on creditors to turn over repossessed property after a bankruptcy filing.

The Third, Tenth and District of Columbia Circuits held that the retention of property only maintains the *status quo*. For those circuits, a stay violation requires an affirmative action. Simply holding property is not an affirmative act, in their view.

The City of Chicago filed a *certiorari* petition in September 2019. To resolve the circuit split, the Supreme Court granted *certiorari* in December 2019. Argument was originally scheduled to be held in April 2020 but was postponed until October as a result of the coronavirus pandemic.

The Statute Demanded the Result

Justice Alito laid out the pertinent statutes. Primarily, Section 362(a)(3) stays "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." In the lower courts, the debtors relied on that section, but not exclusively.

With some exceptions, Section 542(a) provides that "an entity . . . in possession . . . of property that the trustee may use, sell, or lease under section 363 of this title . . . , shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate."

Justice Alito said that the case turned on the "prohibition [in Section 362(a)(3)] against exercising control over estate property." He said the language "suggests that merely retaining possession of estate property does not violate the automatic stay."

To Justice Alito, "the most natural reading" of the words "stay," "act" and "exercise control" mean that Section 362(a)(3) "prohibits affirmative acts that would disturb the status quo of estate property as of the time when the bankruptcy petition was filed." He found a "suggestion" in the "combination" of the words "that §362(a)(3) halts any affirmative act that would alter the status quo as of the time of the filing of a bankruptcy petition."

Justice Alito said that words in Section 362(a)(3) by themselves did not "definitively rule out" the result reached in the Seventh Circuit. "Any ambiguity" in that section, he said, "is resolved decidedly in" Chicago's favor by Section 542.

In view of Section 542, Justice Alito said that reading Section 362(a)(3) to proscribe "mere retention of property" would create two problems.

First, a broad reading of Section 362(a)(3) would "largely" render Section 542 "superfluous." Second, it would make the two sections contradictory. Where Section 542 has exceptions, Section 362(a)(3) has none.

Justice Alito observed that the prohibition against "control" over estate property was added to Section 362 in the 1984 amendments. "But transforming the stay in §362 into an affirmative turnover obligation would have constituted an important change," he said.

It "would have been odd for Congress to accomplish that change by simply adding the phrase 'exercise control,' a phrase that does not naturally comprehend the mere retention of property and that does not admit of the exceptions set out in §542," Justice Alito said.

Justice Alito interpreted the 1984 amendment to mean that it "simply extended the stay to acts that would change the *status quo* with respect to intangible property and acts that would change the *status quo* with respect to tangible property without 'obtain[ing]' such property."

Justice Alito ended his decision by noting what the opinion did not decide. The ruling did not "settle the meaning of other subsections of §362(a)" and did "not decide how the turnover obligation in §542 operates."

"We hold only that mere retention of estate property after the filing of a bankruptcy petition does not violate §362(a)(3) of the Bankruptcy Code." Justice Alito vacated the Seventh Circuit's judgment and remanded for further proceedings.

Justice Sotomayor's Concurrence

Justice Sotomayor said she wrote "separately to emphasize that the Court has not decided whether and when §362(a)'s other provisions may require a creditor to return a debtor's property." She said that the "the City's conduct may very well violate one or both of these other provisions," referring to subsections 362(a)(4) and (6).

In her six-page concurrence, Justice Sotomayor noted that the Court had not "addressed how bankruptcy courts should go about enforcing creditors' separate obligation to 'deliver' estate property to the trustee or debtor under §542(a)."

Although Chicago's conduct may have satisfied "the letter of the Code," she said that the city's policy "hardly comports with its spirit." She went on to explain why returning a car quickly is important so a debtor can commute to work and make earnings to pay creditors under a chapter 13 plan.

"The trouble" with Section 542, Justice Sotomayor said, is that "turnover proceedings can be quite slow" because they entail commencing an adversary proceeding. She ended her concurrence by saying that either the Advisory Committee on Rules or Congress should consider amendments "that ensure prompt resolution of debtors' requests for turnover under §542(a), especially where debtors' vehicles are concerned."

Observations

Prof. Ralph Brubaker agreed with the opinion of the Court. He told ABI that the "Court emphatically confirms the fundamental principle that the text of the automatic stay provision must be interpreted consistent with its most basic and limited purpose of simply maintaining the petition-date status quo. As Judge McKay put it in his *Cowen* opinion for the Tenth Circuit, 'Stay means stay, not go.' That guiding principle should also prove determinative in resolving the potential applicability of § 362(a)(4) and (a)(6), which the Court expressly refused to address."

Prof. Brubaker is the Carl L. Vacketta Professor of Law at the University of Illinois College of Law.

Rudy J. Cerone agreed. He told ABI that Justice Alito reached "the correct result under the history and structure of sections 362(a) and 542." He noted that the ABI Consumer Commission recommended speeding up turnover proceedings. Mr. Cerone is a partner with McGlinchey Stafford PLLC in New Orleans.

Significantly, the Court did not rule on whether debtors could achieve the same result under subsections (4) and (6) of Section 362(a), which prohibit an act to enforce a lien on property and an act to recover a claim.

In one of the cases before the Supreme Court, the bankruptcy court had relied on those other subjections in ruling for the debtor. The Supreme Court did not address subsections (4) and (6) because the Seventh Circuit did not reach those issues.

Consequently, debtors might resurrect a victory either through speedy procedures under Section 542 or a favorable interpretation of subsections (4) and (6). Reliance on the other subsections may not prevail given how Justice Alito would not permit Section 362 to perform all of the work of Section 542.

It is noteworthy how Justice Alito was skeptical that Congress would make major changes in a statute by using only a few words. At the same time, the Supreme Court has been reluctant in recent years to give importance to legislative history. Since legislative history might not succeed in altering the Supreme Court's view of the law, Congress evidently needs to attach bells and whistles to an amendment meant to change the law.

The case is *City of Chicago v. Fulton*, 19-357, 2021 BL 12454, 2021 Us Lexis 496 (Sup. Ct. Jan. 14, 2021).

Supreme Court narrows Spokeo by holding that violation of a statute won't always give rise to standing and the right to sue for damages.

Supreme Court Majority Deals a Blow to Enforcement of Consumer Protection Laws

Trimming back the already narrow definition of standing laid down in *Spokeo Inc. v. Robins*, 578 U.S. 330 (2016), the Supreme Court held 5/4 on June 25 that "an injury in law is not an injury in fact." In other words, a violation of federal law doesn't necessarily confer Article III standing to mount a lawsuit for the recovery of damages provided by statute.

A credit reporting agency maintained a list of individuals who were terrorists, drug traffickers and serious criminals. The majority held that those erroneously on the list had no standing to sue for statutory damages unless the false and defamatory report had been given to a third party.

The opinion is important in bankruptcy because the decision questions whether a debtor or trustee has standing to seek damages for violation of the automatic stay if the debtor can identify no concrete damages apart from violation of the statute. Arguably, the June 25 opinion means that a debtor or trustee is only entitled to an injunction barring further violations of the automatic stay, if the estate suffered no concrete damages from the original stay violation.

Five conservative justices were in the majority. The vigorous dissent by Justice Clarence Thomas indicates that the decision would have gone the other way were Justice Ruth Bader Ginsburg still on the bench.

As pointed out by Justice Thomas's dissent, the majority arguably intruded on the separation of powers by depriving Congress of the ability to define individuals' rights and create remedies to be enforced in federal court. Significantly, however, Justice Thomas explained in his dissent how plaintiffs in the future could bring the same claims in state courts.

Justice Brett M. Kavanaugh wrote the opinion of the Court, joined by Chief Justice Roberts and Justices Samuel A. Alito, Jr., Neil M. Gorsuch and Amy Coney Barrett. Justice Thomas wrote a dissent joined by Justices Stephen G. Breyer, Sonia Sotomayor and Elena Kagan. Justice Kagan wrote a separate dissent, joined by Justices Breyer and Sotomayor.

To read ABI's report on *Spokeo*, click here.

The Terrorist List

The government maintains lists of terrorists, drug traffickers and other serious criminals. For an extra fee, the credit reporting agency would tell its customers if someone's name appeared on the list.

The credit agency listed people with the same or similar names. It did not compare birth dates, Social Security numbers or other available identifiers. Consequently, innocent people could appear on the credit agency's list of terrorists and criminals.

The plaintiff negotiated to buy a car. The dealer refused to sell the car because the prospective buyer's name appeared on the credit agency's list of terrorists and criminals. Of course, the buyer was not a terrorist or criminal. He only shared a name with someone on the government's list.

After being denied the ability to buy a car, the plaintiff requested a copy of his credit report from the credit agency. The agency sent him a copy of the report purporting to be complete, but the report did not show him as being on the list of criminals and terrorists.

Later, the agency sent him a letter telling him that he was a potential match with someone on the government list, but it again did not tell him that the information appeared on his credit report. The letter also did not tell the plaintiff about his rights to remove incorrect information from the credit report, as required by the Fair Credit Reporting Act.

The plaintiff filed a class action in federal district court in California under the FCRA. The class of about 8,000 individuals included everyone who was erroneously on the credit agency's list during a specified time, whether or not their reports had been given to third parties. Among the class, erroneous reports for some 1,900 individuals had been given by the credit agency to third parties.

The class of 8,000 was certified. After trial, the jury awarded each of the 8,000 class members almost $1,000 in statutory damages and some $6,400 in punitive damages, for a total of more than $60 million. The Ninth Circuit affirmed 2/1 but reduced the total award to some $40 million.

The dissenter in the Ninth Circuit believed that class members had no standing if their erroneous reports had not been given to a third party, even though the FCRA gave them the right to damages.

The credit agency filed a petition for *certiorari*, which the Supreme Court granted in December 2020. It is not clear whether there was a circuit split. Oral argument was held on March 30.

The Majority Opinion

After laying out the facts, Justice Kavanaugh recounted the history of Article III standing, which requires that a plaintiff have a "personal stake" in the case. To meet the test, the plaintiff must show that (1) she or he suffered an injury that was concrete, particularized and actual or imminent; (2) the injury was likely caused by the defendant; and (3) the injury would likely be redressed by judicial relief.

In the case before the Court, Justice Kavanaugh said that the question under *Spokeo* was whether "the plaintiff's injury was 'concrete' — that is, 'real, and not abstract.'" *Spokeo*, he said, allowed for various intangible harms to be concrete, such as "reputational harms, disclosure of private information, and intrusion upon seclusion" or abridgement of free speech.

Justice Kavanaugh said that the views of Congress may be "instructive." Legislation, he said, can elevate the status of concrete, *de facto* injuries that previously were inadequate in law.

Quoting the Sixth Circuit, Justice Kavanaugh said that Congress's lawmaking power may not transform something that is not harmful into something that is. Citing *Spokeo*, he said that Article III standing requires a concrete injury even when there has been a statutory violation.

Justice Kavanaugh therefore held that "an injury in law is not an injury in fact. Only those plaintiffs who have been *concretely harmed* by a defendant's statutory violation may sue that private defendant over that violation in federal court." [Emphasis in original.] If the rules of Article III standing were different, he said, "Congress could authorize virtually any citizen to bring a statutory damages suit against virtually any defendant who violated virtually any federal law."

Applying the law to the facts, Justice Kavanaugh had "no trouble" in concluding that the 1,900 class members had suffered "concrete harm" because their erroneous reports had been given to third parties. For the remainder, "the mere presence of an inaccuracy in an internal credit file, if it is not disclosed to a third party, causes no concrete harm."

The plaintiffs cited *Spokeo* for the proposition that the risk of real harm can sometimes satisfy the requirement of concreteness. Justice Kavanaugh countered by saying that someone "exposed to a risk of future harm may pursue forward-looking, injunctive relief to prevent the harm from occurring, at least so long as the risk of harm is sufficiently imminent and substantial."

In other words, a plaintiff must show standing separately for each type of relief. "Therefore," Justice Kavanaugh said, "a plaintiff's standing to seek injunctive relief does not necessarily mean that the plaintiff has standing to seek retrospective damages."

For the majority, Justice Kavanaugh reversed and remanded to the Ninth Circuit. The 1,900 class members whose reports were disseminated to third parties "suffered a concrete harm," but the remainder did not and had no standing.

The Dissent by Justice Thomas

In his dissent joined by three liberal justices, Justice Thomas began by emphasizing the facts. The credit reports "flagged many law-abiding people as potential terrorists and drug traffickers" and in doing so violated several provisions in the FCRA. He continued:

> Yet despite Congress' judgment that such misdeeds deserve redress, the majority decides that [the credit agency's] actions are so insignificant that the Constitution prohibits consumers from vindicating their rights in federal court. The Constitution does no such thing.

Justice Thomas noted how the notion of injury in fact only emerged in 1970, 180 years after ratification of Article III. To the contrary, he said that "courts for centuries held that injury in law to a private right was enough to create a case or controversy." To his way of thinking, the entire class of 8,000 had "a sufficient injury to sue in federal court" given that the jury had found that the credit agency "violated each member's individual rights."

By way of contrast, Justice Thomas characterized the majority as holding that "the mere violation of a personal legal right is *not* — and never can be — an injury sufficient to establish standing." [Emphasis in original.] In that regard, he insinuated that the Court was cutting back on *Spokeo* because the majority had said five years ago that "Congress is well positioned to identify intangible harms that meet minimum Article III requirements" and that "the violation of a procedural right granted by statute can be sufficient in some circumstances to constitute injury in fact." *Spokeo*, *id.*, 578 U.S. at 341, 342.

Justice Thomas characterized the import of the majority's opinion as meaning that "legislatures are constitutionally unable to offer the protection of the federal courts for anything other than money, bodily integrity, and anything else that this Court thinks looks close enough to rights existing at common law . . . . Never before has this Court declared that legal injury is *inherently* insufficient to support standing." [Emphasis in original.]

Consequently, Justice Thomas said, "this Court has relieved the legislature of its power to create and define rights." If characterizing someone as a drug trafficker or terrorist was not enough, he wondered what could rise to the level of sufficient injury. What if someone were falsely labeled as a child molester or a racist? "Or what about openly reducing a person's credit score by several points because of his race?"

"If none of these constitutes an injury in fact, how can that possibly square with our past cases . . . ? Weighing the harms caused by specific facts and choosing remedies seems to me like a much better fit for legislatures and juries than for this Court," Justice Thomas said.

In a footnote near the end of his dissent, Justice Thomas observed that the majority's decision "might actually be a pyrrhic victory" for the credit agency. The Court only held that some of the class lacked standing in federal court.

Justice Thomas said that state courts would become "the sole forum for such cases" because they are not bound by Article III's requirement of a case or controversy. Moreover, defendants could not remove the suits to federal court, because federal courts would have no jurisdiction for lack of an Article III case or controversy.

"By declaring that federal courts lack jurisdiction," Justice Thomas concluded his footnote by saying that "the Court has thus ensured that state courts will exercise exclusive jurisdiction over these sorts of class actions."

Justice Kagan's Dissent

Joined by Justices Breyer and Sotomayor, Justice Kagan further developed the majority's intrusion into the separation of powers. She said that the "Court here transforms standing law from a doctrine of judicial modesty into a tool of judicial aggrandizement. It holds, for the first time, that a specific class of plaintiffs whom Congress allowed to bring a lawsuit cannot do so under Article III."

Justice Kagan said that the reporting agency had "willfully violated" the statute by preparing credit files falsely reporting class members as potential terrorists and by obscuring the mistake when class members requested copies of their files. She said that finding no injury in the real world "is to inhabit a world I don't know. [citation omitted] And to make that claim in the face of Congress's contrary judgment is to exceed the judiciary's 'proper — and properly limited — role,'" quoting *Warth v. Seldin*, 422 U.S. 490, 498 (1975).

Justice Kagan ended her dissent by saying that "Congress is better suited than courts to determine when something causes a harm or risk of harm in the real world. For that reason, courts should give deference to those congressional judgments."

Observations

Assume that a creditor willfully violates the Section 362 automatic stay but causes no injury. After last week's decision, is the debtor or trustee entitled to damages such as attorneys' fees, or is injunctive relief the only remedy?

In this writer's opinion, the majority has reincarnated substantive due process, this time under Article III. If a remedy for an injustice was not known at common law, the majority are saying that relief other than an injunction is beyond the reach of Congress.

The opinion is *TransUnion LLC v. Ramirez*, 20-297 (Sup. Ct. June 25, 2021).

Building on Bullard, the Supreme Court rules unanimously that a lift-stay motion is a "procedural unit" that's appealable if the bankruptcy court "conclusively" denies the motion.

Supreme Court Rules that 'Unreservedly' Denying a Lift-Stay Motion Is Appealable

The Supreme Court ruled unanimously today in *Ritzen v. Jackson Machinery* that an order denying a motion to modify the automatic stay is a final, appealable order "when the bankruptcy court unreservedly grants or denies relief."

In her unanimous opinion for the Court, Justice Ruth Bader Ginsburg said that a lift-stay motion is a "procedural unit" separate from the remainder of the bankruptcy case, even though the decision to retain the stay may be "potentially pertinent to other disputes."

The decision in *Ritzen* may contain a trap for creditors: A bankruptcy court could deny a creditor the right to appeal, perhaps for an extended time, by denying a lift-stay motion without prejudice or offering to reexamine the result in light of subsequent events.

The Facts

Before bankruptcy, the creditor had a contract to buy land from the debtor. The deal never closed, and the creditor sued in state court for breach of contract. Before trial, the debtor filed a chapter 11 petition.

In bankruptcy, the creditor moved to modify the stay so that the state court could decide who breached the contract. The bankruptcy court denied the motion. The creditor did not appeal.

The creditor filed a proof of claim, but the bankruptcy court disallowed the claim, ruling that the creditor, not the debtor, had breached the contract. Without objection from the creditor, the bankruptcy court confirmed the debtor's plan.

The creditor then filed an appeal from denial of the lift-stay motion and from disallowance of the claim. The district court dismissed the stay appeal as untimely and upheld the claim ruling on the merits.

The Sixth Circuit affirmed. *Ritzen Group Inc. v. Jackson Masonry LLC (In re Jackson Masonry LLC)*, 906 F.3d 494 (6th Cir. Oct. 16, 2018). To read ABI's analysis of the Sixth Circuit's opinion, click here.

The creditor filed a petition for *certiorari*, contending there was a split of circuits. The Supreme Court granted *certiorari* in May. The case was argued on November 13.

Bankruptcy Isn't Like Ordinary Litigation

Appealability is governed by 28 U.S.C. § 158(a), which gives district courts jurisdiction over appeals from "final judgments, orders, and decrees . . . in cases and proceedings referred to bankruptcy judges . . . ."

Justice Ginsburg acknowledged that ordinary rules of finality are "not attuned to the distinctive character of bankruptcy litigation." Bankruptcy, she said, is "an aggregation of individual controversies," quoting the *Collier* treatise. She explained why appeals from individual controversies cannot await resolution of the entire bankruptcy case.

The outcome was guided, if not controlled, by *Bullard v. Blue Hills Bank*, 575 U.S. 496 (2015), where the Supreme Court held that denial of confirmation of a chapter 13 plan is not a final, appealable order. She paraphrased *Bullard* as holding that bankruptcy court orders are final when they "definitively dispose of discrete disputes within the overarching bankruptcy case."

To be final under *Bullard*, an order must alter the *status quo* and fix the rights and obligations of the parties, Justice Ginsburg said.

Justice Ginsburg framed the question as whether denial of a lift-stay motion is a "distinct proceeding" that terminates "when the bankruptcy court rules dispositively on the motion." She said that a majority of courts and leading treatises say that denial of a lift-stay motion is immediately appealable.

Addressing the facts of the case on appeal, Justice Ginsburg said that the lift-stay motion was "a procedural unit anterior to, and separate from, claim-resolution proceedings." Stay relief, she said, "occurs before and apart from proceedings on the merits of creditors' claims."

Of potential significance in the future on questions about the finality of other types of orders, Justice Ginsburg said that resolution of a stay motion "can have large practical consequences." For example, leaving the stay in place may "delay collection of a debt or cause collateral to decline in value."

The decision by Justice Ginsburg is a categorical ruling. She saw "no good reason to treat stay adjudication as the relevant 'proceeding' in only a subset of cases." Quoting Supreme Court

authority in another context, she said that finality "should 'be determined for the entire category to which a claim belongs.' *Digital Equipment Corp. v. Desktop Direct Inc.*, 511 U.S. 863, 868 (1994)."

Justice Ginsburg left little room for contending that denial of a lift-stay motion can sometimes be non-final. She said it "does not matter whether the court rested its decision on a determination potentially pertinent to other disputes in the bankruptcy case, so long as the order conclusively resolved the movant's entitlement to the requested relief."

In a footnote at the end of the opinion, Justice Ginsburg said the Court was not deciding whether denial of a motion without prejudice would be final if the bankruptcy court was awaiting "further developments [that] might change the stay calculus."

Affirming the judgment of the Sixth Circuit, Justice Ginsburg held that the stay-relief motion was the "appropriate 'proceeding.'" The order "conclusively denying" the motion was final, she said, because the "court's order ended the stay-relief adjudication and left nothing more for the Bankruptcy Court to do in that proceeding."

Observation

At first blush, the opinion seems beneficial for creditors by assuring them of their right to appeal denials of lift-stay motions. In practice, however, *Ritzen* can be used against creditors.

Suppose the bankruptcy court denies a lift-stay motion without prejudice, saying that unfolding events might persuade the court to modify the stay. Denial of a motion without prejudice could therefore cut off the ability to appeal, exerting leverage in favor of the debtor and persuading the creditor to settle.

In upcoming years, courts may be called upon to grapple with the question of whether denial without prejudice may sometimes have the trappings of a final order.

The opinion is *Ritzen Group Inc. v. Jackson Masonry LLC*, 140 S. Ct. 582, 205 L. Ed. 2d 419 (Sup. Ct. Jan. 14, 2020).

High court rules that federal courts may make federal common law only to protect 'uniquely' federal interests.

Supreme Court Uses a Bankruptcy Case to Limit the Use of Federal Common Law

The Supreme Court ruled in *Rodriguez v. Federal Deposit Insurance Corp.* that federal courts may not employ federal common law to decide who owns a tax refund when a parent holding company files a tax return but a subsidiary generated the losses giving rise to the refund.

In his eight-page opinion for the unanimous court on February 25, Justice Neil M. Gorsuch used a dispute in bankruptcy court to hold that "cases in which federal courts may engage in common lawmaking are few and far between."

The Facts

A bank's holding company was in chapter 7 with a trustee. The bank subsidiary was taken over by the Federal Deposit Insurance Corp. as receiver. The bank subsidiary's losses resulted in a $4 million tax refund payable to the parent under a pre-bankruptcy tax allocation agreement, or TAA, between the parent and the bank subsidiary.

Both the trustee for the holding company and the FDIC, as receiver for the bank, laid claim to the refund. If the holding company owned the refund, the FDIC would have nothing more than an unsecured claim.

The bankruptcy court in Colorado granted summary judgment in favor of the holding company's trustee, concluding that the TAA did not create a trust or agency under Colorado law. In the view of the bankruptcy court, the parent and subsidiary only had a debtor/creditor relationship under the TAA, leaving the FDIC with an unsecured claim for the refund.

On appeal, the district court believed that the Tenth Circuit had adopted the *Bob Richards* rule, first enunciated by the Ninth Circuit in *In re Bob Richards Chrysler-Plymouth Corp.*, 473 F.2d 262 (9th Cir. 1973). *Bob Richards* made a presumption under federal common law that the subsidiary with the losses is entitled to the refund absent a TAA that clearly gives the refund to the parent.

The district court, however, went on to analyze the TAA and found provisions supporting a ruling in favor of the holding company and other provisions where the bank subsidiary would come out on top. The district court ended up relying on tie-breaking language in the TAA that

resolved ambiguity in favor of the bank subsidiary. The district court therefore reversed and awarded the refund to the FDIC.

The Tenth Circuit affirmed the district court, first saying that the appeals court had adopted *Bob Richards* in *Barnes v. Harris*, 783 F.3d 1185 (10th Cir. 2015).

Unlike *Barnes* and *Bob Richards*, the Tenth Circuit said that the case on appeal had a written agreement in the form of the TAA. The appeals court ruled that the tie-breaking provision in the TAA created an agency relationship. In the view of the circuit court, the FDIC was entitled to the refund because the holding company was an agent for the bank.

The Tenth Circuit created ambiguity about the basis for its ruling by saying at the end of the opinion that the result did not differ from the rule in *Barnes* and *Bob Richards*.

The circuits are split 3/4. The Fifth, Ninth and Tenth Circuits have followed *Bob Richards*, while the Second, Third, Sixth and Eleventh Circuits reject *Bob Richards* and employ state law to decide who owns a refund and whether the TAA creates an unsecured debtor/creditor relationship.

The holding company's trustee filed a petition for *certiorari* in April 2019. The Court granted the petition at the end of June to answer the one question presented: Does federal common law (*Bob Richards*) or state law determine the ownership of a tax refund?

Courts Have Only 'Limited Areas' for Making Federal Common Law

The handwriting was on the wall on the second page of the opinion. Justice Gorsuch said that state law — such as "rules for interpreting contracts, creating equitable trusts, avoiding unjust enrichment" — are "readymade" for deciding the ownership dispute.

"Judicial lawmaking," Justice Gorsuch said, "plays a necessarily modest role under a Constitution that vests federal" legislative power in Congress. As a result, "only limited areas exist in which federal judges may appropriately craft the rule of decision." Appropriate areas, he said, are in admiralty law and disputes among states.

Citing Supreme Court precedent, Justice Gorsuch said that federal common law is appropriate only when "necessary to protect uniquely federal interests." He found no federal interest in deciding the owner of the tax refund.

Returning to where he began, Justice Gorsuch said that "state law is well equipped to handle disputes involving corporate property rights." A federal bankruptcy, he said, "doesn't change much."

The Remedy

The trustee and the FDIC disagreed on whether the lower courts relied on *Bob Richards* or decided the case based on state law, but Justice Gorsuch said the Supreme Court did not grant *certiorari* to decide how the case should end up under state law.

Vacating and remanding, Justice Gorsuch said that the Court "took this case only to underscore the care federal courts should exercise before taking up an invitation to try their hand at common lawmaking."

Observations

The case is an example of how the Supreme Court will make law when the justices feel like it, even if there is no longer a dispute between the parties. By the time of oral argument, neither side nor the Solicitor General was defending the *Bob Richards* rule.

With no live controversy regarding *Bob Richards*, several justices made comments at oral argument suggesting that the Court might dismiss the petition as having been improvidently granted. For instance, Justice Ruth Bader Ginsburg said, "we usually don't decide an abstract" question when there is a lack of "adversarial confrontation."

However, several justices seemed primed to strike down *Bob Richards*. Justice Brett M. Kavanaugh said the federal common law was "patently indefensible." Hinting that he would be the author of the Court's opinion, Justice Gorsuch said at oral argument that the outcome should be determined by state law, without "any thumb on the scale by federal common law."

The opinion presents a question for bankruptcy judges: May they announce a rule of bankruptcy common law if the Bankruptcy Code does not provide an answer? Must courts always purport to find an answer in the statute?

The opinion is *Rodriguez v. Federal Deposit Insurance Corp.*, 18-1269 (Sup. Ct. Feb. 25, 2020).

Despite the high court's ban on nunc pro tunc orders, may bankruptcy courts make their orders retroactive?

Supreme Court Bans *Nunc Pro Tunc* Orders

The Supreme Court has banned the term "*nunc pro tunc*" from the bankruptcy lexicon.

In a *per curiam* opinion on February 24, the Court also ruled that a state court altogether lacks jurisdiction in a removed action until the case has been formally remanded. Merely terminating the basis for federal jurisdiction does not restore the state court's jurisdiction and power to act.

The Catholic Church in Puerto Rico filed a petition for *certiorari* in January 2019, contending that rulings by the Puerto Rico Supreme Court violated the Free Exercise and Establishment Clauses of the First Amendment. The Solicitor General filed a brief in December 2019 recommending that the Court grant *certiorari* and reverse the Puerto Rico Supreme Court.

Without holding argument, the Court granted the petition, reversed and remanded, but not on First Amendment grounds. Instead, the Supreme Court ruled that the Puerto Rico courts were without jurisdiction to enter orders at the critical time.

The Complex Facts

The facts and procedural history are complex, but they boil down to this: The Catholic Church in Puerto Rico terminated a pension plan for workers in the island's parochial schools. The workers sued in an island court. Reversing the intermediate appellate court, the Puerto Rico Supreme Court reinstated the orders of the trial court in favor of the workers by directing the church to deposit $4.7 million with the court. Another order directed the sheriff to seize church assets.

Based on the Treaty of Paris of 1898, the Puerto Rico Supreme Court believed that all church entities in Puerto Rico — including schools and parishes — are liable for the debts of their brother and sister Catholic institutions. Because the high court in Puerto Rico had disregarded the corporate separateness of Catholic entities, the church filed a petition for *certiorari*, raising complex questions under the First Amendment.

For the courts in Puerto Rico, there was a jurisdiction problem that had been overlooked. Before the trial court entered its orders to deposit money and seize assets, the church had removed the suit to federal court, contending that it was related to a bankruptcy case that had been filed by the schools' pension trust.

Nothing Happened

The exact timing of events in the island and federal courts was critical to the outcome in the Supreme Court.

On March 13, 2018, the bankruptcy court dismissed the pension trust's bankruptcy, thus ostensibly terminating the basis for removal of the suit against the church entities. Later in March 2018, the Puerto Rico trial court entered the orders to deposit money and attach assets, but the case had not yet been remanded to the island court when the orders were entered.

In fact, the federal court did not enter an order remanding the suit to the Puerto Rico court until August 2018, five months after the island court had entered orders *in that suit* to deposit money and attach assets. However, the remand order in August 2018 stated that it was *nunc pro tunc* to March 13, the day the bankruptcy was dismissed.

In Latin, the phrase means "now for then."

Jurisdiction Strictly Interpreted

A stickler for details, the Supreme Court ruled on the Puerto Rico court's lack of jurisdiction without reaching the merits on the First Amendment.

Because the suit had not been remanded to the island court when the orders were entered, the Supreme Court ruled in its eight-page opinion that the Puerto Rico court "had no jurisdiction over the proceedings. The orders are therefore void."

Citing 19th century authority, the Court said that removal divests the state court of "'all jurisdiction over the case, and, being without jurisdiction, its subsequent proceedings and judgment [are] not . . . simply erroneous, but absolutely void.'" *Kern v. Huidekoper*, 103 U.S. 485, 493 (1881).

The federal court's *nunc pro tunc* order did not save the day. The high court said that a *nunc pro tunc* order may "'reflect[] the reality'" of what has occurred, citing *Missouri v. Jenkins*, 495 U.S. 33, 49 (1990). A *nunc pro tunc* order, the Court said, "presupposes" that a court has made a decree that was not entered on account of "inadvertence," citing *Cuebas y Arredondo v. Cuebas y Arredondo*, 223 U.S. 376, 390 (1912).

The Supreme Court said that nothing had occurred in the federal court in terms of remand on March 13, the date to which the court had made the remand *nunc pro tunc*. Therefore, the high court ruled that a "court 'cannot make the record what it is not,'" citing *Jenkins*, 495 U.S. at 49.

What Does It Mean for Bankruptcy?

Bankruptcy courts often make orders *nunc pro tunc*. Based on the Supreme Court's opinion, a *nunc pro tunc* order is proper only if the court announces its ruling without immediate entry of an order.

May a bankruptcy court nonetheless make an order retroactive? For example, a retention order at the outset of a case may not be entered for several days or weeks. May retention be made retroactive to the date the application was filed, assuming it was later granted? Or, will courts be required to enter provisional orders immediately?

The opinion is *Roman Catholic Archdiocese of San Juan v. Acevedo Feliciano*, 140 S. Ct. 696, 206 L. Ed. 2d 1 (2020) (Sup. Ct. Feb. 24, 2020).

The Supreme Court reversed the First Circuit, which had held that the Oversight Board violated the Appointments Clause because the members were not appointed by the President and confirmed by the Senate.

Supreme Court Finds No Appointment Clause Violation in Puerto Rico's Oversight Board

Although the members of the Financial Oversight and Management Board of Puerto Rico were not nominated by the President nor confirmed by the Senate, the Supreme Court ruled on June 1 that the appointment of the Board did not violate the Appointments Clause of the Constitution because they exercise "primarily local duties."

All of the justices agreed in the judgment reversing the First Circuit, which had held that the Board's appointment violated the Appointments Clause. The decision by the high court means there will be no lingering doubt about the validity of Puerto Rico's debt arrangement.

Justice Stephen G. Breyer wrote the opinion of the court.

Justices Clarence Thomas and Sonia Sotomayor concurred in the judgment, which means they agreed with the result but for different reasons. In her opinion, Justice Sotomayor raised but did not answer questions about the ability of Congress to set aside Puerto Rico's democratically elected government by appointing a federal board to take over the island commonwealth's fiscal powers and responsibilities.

The Creation and Appointment of the Oversight Board

The Supreme Court ruled in June 2016 that Puerto Rico was ineligible for chapter 9 municipal bankruptcy. To allow the island commonwealth to restructure its unsupportable debt, Congress almost immediately adopted the Puerto Rico Oversight, Management, and Economic Stability Act, or PROMESA (48 U.S.C. §§ 2161 *et. seq.*).

The members of the Oversight Board were not nominated by the President nor were they confirmed by the Senate. Rather, PROMESA allowed the President to appoint one member of the Oversight Board. The President selected six more from a list of candidates provided by leaders of Congress. If any members appointed by the President were not on the congressional list, Senate confirmation would have been required. Since the six were all on the list, there was no Senate confirmation.

The Oversight Board commenced debt-adjustment proceedings for the commonwealth and its instrumentalities beginning on May 3, 2017, in district court in Puerto Rico. Aurelius Investment LLC and affiliates filed a motion in August 2017 seeking dismissal of Puerto Rico's debt-arrangement proceedings, arguing that the filing of the petition on behalf of the Commonwealth of Puerto Rico by the Board under Title III of PROMESA violated the Appointments Clause. The Oversight Board, the official unsecured creditors' committee, and COFINA bondholders, among others, opposed Aurelius.

Designated by the Chief Justice and sitting in the District of Puerto Rico to preside over the PROMESA proceedings, District Judge Laura Taylor Swain of New York handed down an opinion in July 2018 holding the Board was properly constituted under the Territories Clause of the Constitution, Article IV, Section 3, Clause 2. *In re Financial Oversight and Management Board for Puerto Rico*, 318 F. Supp. 3d 537 (D.P.R. July 13, 2018). To read ABI's discussion of the district court opinion, click here.

The First Circuit Reversal

On appeal, the First Circuit reversed, holding that the appointment of the members of the Oversight Board violated the Appointments Clause because they were not nominated by the President and confirmed by the Senate. Relying on the *de facto* officer doctrine, the appeals court went on to rule that its opinion would "not eliminate any otherwise valid actions of the Board prior to the issuance of our mandate in this case." *Aurelius Investment LLC v. Commonwealth of Puerto Rico*, 915 F.3d 838 (1st Cir. Feb. 15, 2019). For ABI's report on the First Circuit opinion, click here.

The appeals court entered an order that operated as a stay to remain in effect until the Supreme Court ruled on the case.

The Oversight Board filed a petition for *certiorari* in April 2019. Four other petitions followed, by the U.S. Solicitor General, Aurelius, the official creditors' committee, and a labor union in Puerto Rico.

The Supreme Court granted *certiorari* on June 20 to decide two questions: (1) Should the members of the Oversight Board have been nominated by the President and confirmed by the Senate; and (2) if the appointment was unconstitutional, does the *de facto* officer doctrine validate actions already taken by the Oversight Board?

Oral argument took place on October 15. To read ABI's report on oral argument, click here.

In retrospect, two issues raised by the justices at oral argument presaged the result: (1) Were they to uphold the First Circuit, some justices were concerned that the precedent would undermine

the governance of the District of Columbia and the territories; and (2) Counsel for the Oversight Board and the bondholders agreed that the case turned on whether the Board acted primarily locally or primarily nationally.

Counsel for the Board argued that its members were performing primarily local functions because they were supplanting Puerto Rico's legislature and governor. The bondholders contended that the Board's functions were national in scope because the proceedings would affect billions of dollars of investments and investors throughout the country who held the debt.

The Opinion for the Court by Justice Breyer

The Appointments Clause of the Constitution, Art. II, §2, cl. 2, provides that the President "shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States . . . ."

To decide whether Board members are Officers of the U.S., Justice Breyer — like Justice Thomas — leaned heavily on eighteenth century history and actions taken by Congress in dealing with territories immediately after adoption of the Constitution.

Justice Breyer quickly made a distinction between "ordinary" officers of the U.S. to whom the Appointments Clause applies and officers of the District of Columbia and the territories to whom the clause may nor may not apply in view of Article I, §8, cl. 17, pertaining to the District, and Article IV, §3, cl. 2, applicable to territories.

Justice Breyer did not leave the reader wondering about the result.

On the first page of his 22-page decision, he said that the "Board's statutory responsibilities consist of primarily local duties, namely, representing Puerto Rico in bankruptcy proceedings and supervising aspects of Puerto Rico's fiscal and budgetary policies." He held "that the Board members are not 'Officers of the United States.' For that reason, the Appointments Clause does not dictate how the Board's members must be selected."

Justice Breyer did not disagree entirely with the First Circuit. He agreed with the Boston-based appeals court to the extent that "Appointments Clause restricts the appointment of all officers of the United States, including those who carry out their powers and duties in or in relation to Puerto Rico."

In other words, he held that the clause applies to "*all* 'Officers of the U.S,' . . . even when those officers exercise power in or related to Puerto Rico." [Emphasis in original.] Although the Appointments Clause applies to officers of the District of Columbia and the territories, he limited the holding by saying that the clause "*does not* restrict the appointment of local officers that

Congress vests with primarily local duties under Article IV, §3, or Article I, §8, cl. 17." [Emphasis in original.]

Justice Breyer then turned to the question of whether the Board's powers and duties were primarily local. Parsing PROMESA, he concluded that "the Board's members have primarily local duties, such that their selection is not subject to the constraints of the Appointments Clause."

Rejecting the bondholders' reliance on the nationwide effect of the Board's decisions, Judge Breyer said that "[t]aking actions with nationwide consequences does not automatically transform a local official into an 'Officer of the U.S.'" The "same might be said of any major municipal, or even corporate bankruptcy."

Basing the ruling on the Appointments Clause, Justice Breyer avoided having to overrule the so-called Insular Cases from the very early twentieth century, which have been criticized for justifying colonialism. He was also not required to opine on the *de facto* officer doctrine.

The Concurrence by Justice Thomas

In his 11-page opinion, Justice Thomas agreed there was no violation of the Appointments Clause. However, he could not agree with the majority's "dichotomy between officers with 'primarily local versus primarily federal' duties," which he called an "amorphous test."

Instead, Justice Thomas relied on his understanding of the "original meaning" of the Appointments Clause. In his view, Board members are territorial officers performing duties under Article IV of the Constitution and "are not federal officers within the original meaning of that phrase . . . ."

Justice Thomas would also reverse the First Circuit, because the Board's members perform duties under Article IV and thus "do not qualify as 'Officers of the U.S.'" In his view, the majority's "primarily local" test would enable Congress to evade the Appointments Clause "by supplementing an officer's federal duties with sufficient territorial duties, such that they become 'primarily local,' whatever that means."

The Concurrence by Justice Sotomayor

The opinion by Justice Sotomayor is required reading for anyone concerned about depriving residents of Puerto Rico of their constitutional rights. She focused on the 1950 compact with Puerto Rico, enacted by Congress as Pubic Law 600, where residents of the island were given the right of self-governance.

In her 24-page opinion, Justice Sotomayor repeatedly asked whether Congress had the right to take away Puerto Rico's self-governance once residents of the island had been ability to elect their

own officials. At a minimum, she questioned whether taking away rights of self-governance turned the Board members into federal officials.

The board members "exist in a twilight zone of accountability," Justice Sotomayor said, because they were "neither selected by Puerto Rico itself nor subject to the strictures of the Appointments Clause. I am skeptical that the Constitution countenances this freewheeling exercise of control over a population that the Federal Government has explicitly agreed to recognize as operating under a government of their own choosing, pursuant to a constitution of their own choosing."

Justice Sotomayor "reluctantly" concurred in the judgment because, in her view, the most important issues were not presented in the case. She saw the case as raising a "serious questions about when, if ever, the Federal Government may constitutionally exercise authority to establish territorial officers in a Territory like Puerto Rico, where Congress seemingly ceded that authority long ago to Puerto Rico itself."

The opinion is *Financial Oversight and Management Board for Puerto Rico v. Aurelius Investment LLC*, 18-1334 (Sup. Ct. June 1, 2020).

The 'fraud-specific discovery rule' might permit FDCPA suits filed more than one year after the occurrence that gives rise to the claim.

Supreme Court Might Allow FDCPA Suits More than a Year After Occurrence

While closing one door, the Supreme Court opened another door today for debtors to argue that the statute of limitations does not begin to run until discovery of the existence of a claim under the federal Fair Debt Collection Practices Act, or FDCPA, 15 U.S.C. § 1692-1692p.

In 2008, a debt collector filed suit on a defaulted credit card debt. Later that year, the debt collector withdrew the suit because the complaint had been served on someone who was not the debtor at a home where the debtor was no longer living.

In 2009, the debt collector sued a second time, again serving someone not the debtor at the same address where the debtor was no longer living. There being no answer, the debt collector got a default judgment.

The debtor did not learn about the second suit until 2014, when he was denied a mortgage on account of the default judgment. Less than one year after discovery, the debtor filed suit, raising a claim under the FDCPA because the debt was allegedly time-barred. He contended that the one-year statute of limitations under the FDCPA was equitably tolled because the debt collector used a manner of service designed to ensure that the debtor would not receive service.

The Circuit Split

The district court dismissed the suit under the statute of limitations and was upheld in the Third Circuit. The Supreme Court granted *certiorari* to resolve a split of circuits.

In 2009, the Ninth Circuit had applied the so-called discovery rule in holding that limitations periods in federal practice generally begin to run when the plaintiff knows or has reason to know of the injury. *Mangum v. Action Collection Serv., Inc.*, 575 F.3d 935 (9th Cir. 2009).

En banc, the Third Circuit rejected the Ninth Circuit's holding by ruling that the statute begins to run when the violation occurs.

The Majority Opinion

Ostensibly, the case was governed by Section 1692k(d) of the FDCPA, which provides that suit must be brought "within one year from date on which the violation occurs."

Justice Clarence Thomas upheld the judgment of the Third Circuit in an opinion on December 10. Based on "dictionary definitions" of the words "violation" and "occurs," he said that the statute "unambiguously sets the date of the violation as the event that starts the one-year limitations period."

Justice Thomas described the Ninth Circuit's "discovery rule" as a "bad wine of recent vintage," citing a concurring opinion by the late Justice Antonin Scalia. According to Justice Thomas, "'Atextual judicial supplementation is particularly inappropriate when, as here, Congress has shown that it knows how to adopt the omitted language or provision."

In his brief, the debtor argued for the Court to follow a fraud-specific discovery rule with roots in 19th century Supreme Court precedent. *Bailey v. Glover*, 21 Wall. 342 (1875).

Justice Thomas did not reach the fraud-specific discovery rule. He said the debtor had not preserved the issue in the Ninth Circuit and did not raise the question in his petition for *certiorari*.

The Ginsburg Dissent

Justice Ruth Bader Ginsburg dissented from the judgment affirming the Third Circuit. She believes the debtor had preserved the issue in the appeals court and adequately raised the question in the *certiorari* petition.

Justice Ginsburg described the debt collector as having "employed fraudulent service to obtain and conceal the default judgment that precipitated [the debtor's] FDCPA claim."

"That allegation, if proved," she said, "should suffice under the fraud-based discovery rule, to permit adjudication of [the debtor's] claim on its merits."

The Sotomayor Concurrence

For future litigation on the FDCPA's statute of limitations, the concurring opinion by Justice Sonia Sotomayor is the most significant.

Justice Sotomayor agreed with the majority that the statute "typically" begins to run when the violation occurs, not when the debtor discovers the violation.

Unlike Justice Ginsburg, Justice Sotomayor also agreed with the majority that the debtor had not preserved the "equitable, fraud-specific discovery rule" in the Third Circuit. She therefore concurred in the judgment.

Justice Sotomayor wrote separately, she said, "to emphasize that this fraud-specific equitable principle is not the 'bad wine of recent vintage' of which my colleagues speak." Rather, she said, "the Court has long 'recogni[zed]' and applied this 'historical exception for suits based on fraud.'"

Justice Sotomayor ended her concurrence by telling future litigants that "[n]othing in today's decision prevents parties from invoking that well-settled doctrine."

The opinion is *Rotkiske v. Klemm*, 140 S. Ct. 355, 205 L. Ed. 2d 291 (Sup. Ct. Dec. 10, 2019).

The Supreme Court uses a copyright case to explain why the bankruptcy exception to states' sovereign immunity is unique under the Constitution.

Supreme Court Explains Sovereign Immunity in Bankruptcy Cases

A decision on state sovereign immunity involving copyrights allowed the Supreme Court to explain the rationale underlying *Central Virginia Community College v. Katz*, 546 U.S. 356 (2006), the high court's authority largely abrogating states' sovereign immunity in bankruptcy cases.

Scholars will argue whether the Supreme Court's March 23 copyright decision modified *Katz*. The answer is, "Probably not much, if at all." However, the Court's discussion of *stare decisis* suggests that the justices are not likely to revisit *Katz*.

Seminole Tribe

The Court's seminal decision on state sovereign immunity is *Seminole Tribe of Florida* v. *Florida*, 517 U.S. 44 (1996). There, the justices laid down two hurdles for congressional abrogation of sovereign immunity.

First, Congress must abrogate sovereign immunity using "unequivocal statutory language." *Id*. at 56. Second, the Constitution must have a provision allowing Congress to encroach on the state's sovereign immunity.

Seminole Tribe was a 5/4 decision, with justices divided along ideological lines. It led to a concern that sovereign immunity would preclude bankruptcy courts from disallowing claims filed by states or allow states to disregard the discharge of claims.

Katz largely laid those concerns to rest. The high court held that proceedings to set aside a preference were not barred by sovereign immunity because bankruptcy proceedings are essentially *in rem*.

The Copyright Case

This term, the Supreme Court granted *certiorari* in *Allen v. Cooper* because the Fourth Circuit held that a federal statute was invalid.

Allen involved a photographer who had taken pictures of an early 18th century shipwreck that belonged to the State of North Carolina. The photographer copyrighted the pictures.

Years later, the state published photos, and the photographer sued for copyright infringement. The district court allowed the suit to go forward, ruling that Congress abrogated sovereign immunity for copyright infringement in the Copyright Remedy Clarification Act of 1990, or CRCA.

The Fourth Circuit reversed on an interlocutory appeal, holding that the CRCA was invalid as to copyrights.

The Supreme Court Decision

The result was largely a foregone conclusion. In *Florida Prepaid Postsecondary Ed. Expense Bd.* v. *College Savings Bank*, 527 U.S. 627 (1999), the Supreme Court ruled that the CRCA did not validly extinguish sovereign immunity with regard to patents.

In her March 23 opinion for the Court, Justice Elena Kagan surveyed the rationale behind *Seminole Tribe* and the limits on the power of Congress to abrogate sovereign immunity.

Because *Florida Prepaid* had invalidated the CRCA as to patents, it was a short hop for Justice Kagan to hold that the CRCA's abrogation of sovereign immunity was also invalid as to copyrights.

The Discussion of *Katz*

Opposing the conclusion reached by Justice Kagan, the photographer based much of his argument on *Katz*, another 5/4 decision, but with the more liberal justices in the majority this time. In short, Justice Kagan said that *Katz* was inapplicable to copyrights.

Florida Prepaid said that Congress could not use the power of Congress over patents in Article I to end sovereign immunity. Given that the Bankruptcy Clause of the Constitution is also in Article I, how does it follow that the Court reached a contrary conclusion in *Katz*?

Katz, Justice Kagan said, "held that Article I's Bankruptcy Clause enables Congress to subject nonconsenting States to bankruptcy proceedings (there, to recover a preferential transfer). We thus exempted the Bankruptcy Clause from *Seminole Tribe's* general rule that Article I cannot justify haling a State into federal court."

"In bankruptcy, we decided, sovereign immunity has no place," Justice Kagan said bluntly.

Everything in *Katz* "is about and limited to the Bankruptcy Clause; the opinion reflects what might be called bankruptcy exceptionalism. In part, *Katz* rested on the 'singular nature' of bankruptcy jurisdiction. That jurisdiction is, and was at the Founding, 'principally *in rem*' . . . ," Justice Kagan said. [Citation omitted.]

Justice Kagan continued, saying that "*Katz* focused on the Bankruptcy Clause's 'unique history.' The [Bankruptcy] Clause emerged from a felt need to curb the States' authority." [Citation omitted.] The Bankruptcy Clause, she said, "was *sui generis* . . . among Article I's grants of authority."

Justice Kagan went on to say that the Bankruptcy Clause "had a yet more striking aspect . . . . [T]he Court . . . went further [in *Katz* and] found that *the Bankruptcy Clause itself* did the abrogating . . . . Or stated another way, we decided that no congressional abrogation was needed because the States had already 'agreed in the plan of the Convention not to assert any sovereign immunity defense' in bankruptcy proceedings." [Emphasis in original; citations omitted.]

In other words, the states waived sovereign immunity in bankruptcies by having adopted the Constitution. In Justice Kagan's terms, sovereign immunity in bankruptcy is "governed by principles all of its own."

Stare Decisis

Writing about *Allen*, we would be remiss if we did not mention Justice Kagan's discussion of *stare decisis* and the dissent by Justice Clarence Thomas.

Finding no difference between patents and copyrights, Justice Kagan said that the Court could have no other result in view of *Florida Prepaid* and the principle of *stare decisis*.

To reverse one of the Court's own precedents, Justice Kagan said there must be special justification over and above a belief that the precedent was wrongly decided.

Justice Thomas concurred in the judgment because he saw *Florida Prepaid* to be "binding precedent." However, he disagreed with Justice Kagan's discussion of *stare decisis*.

Requiring "'special justification . . . does not comport with our judicial duty under Article III,'" Justice Thomas said, quoting one of his prior concurring decisions.

In a footnote, Justice Thomas said he continues to believe that *Katz* was "wrongly decided."

Finally, we note how the justices remain split on the larger questions regarding sovereign immunity.

In *Allen*, Justices Stephen G. Breyer and Ruth Bader Ginsburg concurred in the judgment. They believe that *Seminole Tribe* was wrongly decided. They concurred in the judgment because their "longstanding view has not carried the day."

The opinion is *Allen v. Cooper*, 18-877, 140 S. Ct. 994, 206 L. Ed. 2d 291 (Sup. Ct. March 23, 2020).

Faculty

Rosa J. Evergreen is a partner in the Washington, D.C., office of Arnold & Porter Kaye Scholer LLP in its Bankruptcy and Restructuring group. She has experience in all aspects of bankruptcy and corporate restructuring, including complex chapter 11 cases, asset dispositions and bankruptcy litigation, as well as out-of-court restructurings and receivership cases. Ms. Evergreen has been involved in bankruptcy cases in a wide range of industries across the country, including financial services, retail, real estate, environmental, oil and gas, hospitality and health care, among others. She has been involved in a number of large bankruptcies, including AbitibiBowater, Adelphia, ASARCO, Borders, Circuit City, Extraction Oil & Gas, General Motors, LandAmerica, Lehman Brothers, Quebecor, Reader's Digest, The PMI Group, Vertis and Windstream. Ms. Evergreen has acted on behalf of corporate debtors, secured and unsecured creditors, bondholders, lenders, trade vendors and suppliers, landlords, contract counterparties, private equity funds, investors and asset-purchasers, and individuals and businesses involved in bankruptcy court litigation. She also has experience advising boards of directors and individual officers and directors in insolvency-related matters. Ms. Evergreen is active in many bankruptcy-related professional organizations, including ABI, the International Women's Insolvency & Restructuring Confederation and Turnaround Management Association. Ms. Evergreen has been recognized in *Chambers USA*, *The Best Lawyers in America*, *Washington, DC Super Lawyers* and *Washingtonian Magazine*. She was named one of 12 "Outstanding Young Restructuring Lawyers" by *Turnarounds & Workouts* for 2017, and she was named one of ABI's "40 under 40" emerging leaders for 2018. In 2023, *The Deal* recognized her as being among the "Top Women in Dealmaking," and in 2024, she edited *Driving the Recovery Bus: Augmenting Creditor Recoveries Through Claims Brought by a Litigation Trustee*, published by ABI. Ms. Evergreen maintains an active *pro bono* practice and received the DC Bar's Laura N. Rinaldi Pro Bono Lawyer of the Year Award for 2018. Prior to joining Arnold & Porter, she was a law clerk to Hon. Stephen C. St. John of the U.S. Bankruptcy Court for the Eastern District of Virginia. Ms. Evergreen received her B.A. from Georgetown University and her M.B.A. and J.D. from William & Mary.

Hon. Craig T. Goldblatt is a U.S. Bankruptcy Judge for the District of Delaware in Wilmington, appointed in April 2021. Prior to his appointment, he was a bankruptcy litigator in the Washington, D.C. office of WilmerHale, where his practice primarily involved the representation of financial institutions and other commercial creditors in complex bankruptcy litigation and appeals. Earlier in his career, Judge Goldblatt clerked for Hon. Richard D. Cudahy of the U.S. Court of Appeals for the Seventh Circuit and Hon. David H. Souter of the U.S. Supreme Court. He is a Conferee in the National Bankruptcy Conference (for which he serves as Secretary) and is a vice president of the American College of Bankruptcy. He also has been active on the Business Bankruptcy Committee of the American Bar Association's Business Law Section. Judge Goldblatt has served on the Education Committee of the National Conference of Bankruptcy Judges and as an adjunct professor at Georgetown University Law Center and George Washington University Law School, where he teaches classes focused on bankruptcy law. He has helped coach teams of law students (from George Washington University Law School, Howard Law School and Temple Law School) in the Duberstein Moot Court Competition for each of the past seven years. Judge Goldblatt received his Bachelor's degree *magna cum laude* from Georgetown University in 1990 and his J.D. with honors from the University of Chicago Law School in 1993, where he served as comment editor of the *University of Chicago Law Review*.

Hon. John T. Gregg is a U.S. Bankruptcy Judge for the Western District of Michigan in Grand Rapids, appointed on July 17, 2014. He currently serves on the Bankruptcy Appellate Panel for the Sixth Circuit. Previously, Judge Gregg was a partner with the law firm of Barnes & Thornburg LLP, where he focused on corporate restructuring, bankruptcy and other insolvency matters. Judge Gregg served as chair of the education committee of the National Conference of Bankruptcy Judges for 2022, serves on ABI's Board of Directors, and is a Fellow of the American College of Bankruptcy, and he is a member of the American Law Institute. He is a frequent writer and speaker on bankruptcy and other commercial issues, and he has written and co-edited numerous secondary sources, including *Collier Guide to Chapter 11*, published by LexisNexis; *Strategies for Secured Creditors in Workouts and Foreclosures*, published by ALI-ABA; *Issues for Suppliers and Customers of Financially Troubled Auto Suppliers*, published by ABI; *Michigan Security Interests in Personal Property*, published by the Institute of Continuing Legal Education; *Handling Consumer and Small Business Bankruptcies in Michigan*, published by the Institute of Continuing Legal Education; *Interrupted! Understanding Bankruptcy's Effects on Manufacturing Supply Chains*, published by ABI; and *Receiverships in Michigan*, published by the Institute of Continuing Legal Education. Judge Gregg received his B.A. in 1996 from the University of Michigan and his J.D. in 2002 from DePaul University College of Law.

Hon. Patricia M. Mayer is a U.S. Bankruptcy Judge for the Eastern District of Pennsylvania in Reading and Philadelphia, appointed in October 2019 after 22 years of private practice representing consumers and small business debtors in bankruptcy. Judge Mayer was sworn in on March 11, 2020, just days before the statewide shutdown due to COVID-19, and she spent her first year on the "virtual bench." Judge Mayer is a past chair of the Eastern District of Pennsylvania Bankruptcy Conference, was a board member and volunteer attorney for the Consumer Bankruptcy Assistance Project (CBAP), and was a Third Circuit community leader for the National Association of Consumer Bankruptcy Attorneys (NACBA). She also was a frequent lecturer and course-planner for the Pennsylvania Bar Institute. In 2014, Judge Mayer served on the Local Rules Committee, tasked with drafting the Model Chapter 13 plan used in the district, as well as a comprehensive review and revision of the Local Rules. Previously, she was a partner with the firm of Waterman & Mayer, LLP in Yardley, Pa., where she represented individuals and small business owners in consumer bankruptcy cases, IRS collections matters and mortgage foreclosure defense cases. Judge Mayer currently serves on the Bankruptcy Education Advisory Committee for the Federal Judicial Center (FJC) and is a member of the Public Outreach Committee and Rules Committee for the National Conference of Bankruptcy Judges (NCBJ). She received her B.A. *magna cum laude* in politics from DeSales University and her J.D. from Temple University School of Law, where she received the Barrister's Award for Excellence in Trial Advocacy.

Bill Rochelle is ABI's editor-at-large, based in New York. He joined ABI in 2015 and writes every day on developments in consumer and reorganization law. For the prior nine years, Mr. Rochelle was the bankruptcy columnist for Bloomberg News. Before turning to journalism, he practiced bankruptcy law for 35 years, including 17 years as a partner in the New York office of Fulbright & Jaworski LLP. In addition to writing, Mr. Rochelle travels the country for ABI, speaking to bar groups and professional organizations on hot topics in the turnaround community and trends in consumer bankruptcies. He earned his undergraduate and law degrees from Columbia University, where he was a Harlan Fiske Stone Scholar.