CASE LAW UPDATE COMMERCIAL LAW LEAGUE OF AMERICA
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JENNER&BLOCK

Supreme Court Corner

Resolved Cases

- ***Harrington v. Purdue Pharma L.P.*, 603 U.S. 204 (2024)**. Purdue Pharma Issue: The facts are that Purdue Pharma, a Chapter 11 Debtor, confirmed a plan that released third-party claims against non-debtors, primarily members of the Sackler family who owned Purdue Pharma. The issue is whether there is any statutory authority that permits a bankruptcy court to confirm a chapter 11 plan containing non-consensual third-party releases. In addition to the statutory authority question, this case implicated critical questions of the standing of the United States Trustee, public policy and the Seventh Amendment right to a jury trial.
- On June 27, 2024, the U.S. Supreme Court reversed the decision of the Court of Appeals for the Second Circuit. The Court held that the catch all clause in 11 U.S.C. § 1123(a)(6) does not provide a sufficient statutory basis for non-consensual third-party releases.

- The Court applied the old cannon of construction *ejusdem generis* to conclude that the catch all clause in section 1123(a)(6) must be related to the specific provisions contained in the section, stating that the plan "may include any other appropriate provision not inconsistent with the applicable provisions of this title," still requires the plan provision in question to be sufficiently similar in kind to the specific provisions authorized in subsections 1123(a)(1)-(5)—each of which the Court observed only modify the rights and obligations between the debtor and its creditors, not the rights and obligations among non-debtor third parties.

Open Issues

- 7th Amendment
- 11 U.S. 524(e)
- 100% Plans
- Exculpation
- Chapter 15

- Consensual Third-Party Releases
  - opt in's
  - opt outs
- A plan that has been substantially consummated. Scouting America
- Injunctions only

Chapter 15

- ***In re Credito Real SAB de CV,*** **25-10208 (Bankr. Del. April 1, 2025).**
- At the request of a Mexican Bankruptcy Court, the Delaware bankruptcy court in a Chapter 15 case approved and recognized a plan which provided for third party releases arising from a Mexican Bankruptcy.
- There is now an appeal pending.

OPT Out

- ***In re Smallhold, Inc.*, 2024 Bankr. LEXIS 2332 (Bankr. D. Del. Sept, 25, 2024).** Court rejects opt-out third-party releases for non-voting creditors. The subchapter V debtor proposed a plan that provided for third-party releases. The ballots for the general unsecured class provided that a vote for or against the plan would constitute a consent to the third-party release. But the ballot also contained an opt-out checkbox, which the creditor could check whether voting for or against the plan. Under Harrington v. Purdue Pharma L.P., 144 S. Ct. 2017 (2024), the Code does not permit a plan to include a nonconsensual third-party release, but the Court did not express a view on whether a consensual release was permitted or what constitutes consent. Consent requires either an affirmative act or a failure to object to a court demand that the Code authorizes. For example, failure to object to a cure amount for an assumed executory contract. Because the Code does not authorize the release without consent, the failure to object cannot result in a "default" against the non-objecting creditor. But where the creditor takes an affirmative action that the debtor advises will be construed as consent, the creditor may be bound. Thus, a creditor who fails to opt out of the consent is deemed to consent. At the same time, a creditor who does not vote at all is not deemed to consent, because the creditor has given no indication of consent.

OPT Out

- ***In re Tonawanda Coke Corp.*, 662 B.R. 220 (Bankr. W.D.N.Y. 2024).** Opt-out third-party release is effective. The debtor proposed a plan with an opt-out third-party release. The disclosure statement provided detailed, specific notice about the plan, the objection and voting deadlines, the opportunity to opt out of the release, and the types of claims and parties being released. The releases were narrowly tailored to the case, covering only matters relating to the debtors and the estates, and carved out claims unrelated to the debtors. The release was integral to the plan and a condition of the plan settlements. More than 100 creditors opted out of the release. Under *Harrington v. Purdue Pharma L.P.*, 144 S. Ct. 2017 (2024), the Code does not permit a plan to contain a nonconsensual third-party release, but the Court did not express a view on whether a consensual release was permitted or what constitutes consent. Because opt-out releases of the kind the plan contemplated have been common in this judicial district, the Supreme Court did not address them, and notice was clear and adequate (as evidenced by the number of creditors who opted out), the court finds no reason to change the district's practice and overrules an objection to the inclusion of opt-out third-party releases in the plan. *In re Robertshaw US Holding Corp.*, 662 B.R. 300 (Bankr. S.D. Tex. 2024).

U.S. Trustee Fees

- ***Off. of United States Tr. v. John Q. Hammons Fall 2006, LLC*, 602 U.S. 487 (2024).** Congress authorized the Office of the U.S. Trustee to increase quarterly fees payable by chapter 11 debtors in districts in which it operates. The fee increase did not affect chapter 11 debtors in non-U.S. Trustee Districts. The U.S. Supreme Court previously struck down the fee increase as a non-uniform act of bankruptcy in contravention to the U.S. Constitution. *Siegel v. Fitzgerald,* 142 S. Ct. 177 (2022). However, the Court left open the remedy. The U.S. Trustee claims that Chapter 11 estates are only entitled to prospective relief, while the affected debtors claim the relief is retroactive and they are entitled to a refund of the fees they paid. On June 14, 2024, the Court, in a six-to-three decision ruled that there would be no retroactive relief. The majority felt that it would be far too complicated to unscramble the egg. In addition, the program was to be self-funding. Refunds, however, would come out of the treasury. Justice Gorsuch, on the other hand, pointed out “what’s a constitutional wrong worth these days? Apparently, not much.”

Standing

- ***Truck Insurance Exchange v. Kaiser Gypsum Co*****., 602 U.S. 268 (2024).** The Court considered whether an insurer with ultimate financial responsibility for a bankruptcy claim is a "party in interest" that may object to a Chapter 11 plan of reorganization. This is a standing case which raises the issue of both Article III standing and statutory standing under 11 U.S.C. § 1109. On June 6, 2024, the Court by a vote of eight to zero (with Justice Alito not participating) reversed the Court of Appeals and held that 11 section 1109 gives standing to insurance companies to be heard. Many Courts of Appeal had adhered to the unspoken premise that insurance companies were bothersome and would only complicate and frustrate the purposes of Chapter 11. Insurance companies do not have to be creditors, but only show that the plan of reorganization would impair their rights, which this particular plan did.

In re Sears Holdings Corp 2024 U.S. App. Lexis31971 (2d Cir. December 16, 2024)

- In 2023, the U.S. Supreme Court ruled that 11 U.S.C. § 363(m) was not jurisdictional and remanded the matter back to the Court of Appeals. However, that was not the end of it. The parties have spent the last two years in three tiers of Federal Courts litigating the fate of the relevant lease. Mall of America, owned by MOAC Mall Holdings LLC, is the largest indoor shopping mall in America. It concluded that it could attract retailers if it had solid anchor tenants. It entered a 100-year lease with Sears in 1991. Sears was required to pay just $10.00 per year which it prepaid for the first thirty years. In addition, Sears was obligated to pay property taxes and other fees and charges amounting to between $1.1 and $1.2 million a year. Finally, Sears had the right to cease operations after fifteen years and to sublease the space or assign the MOAC lease without obtaining MOAC's consent. the position that under 11 U.S.C. § 364(d)(4) the lease was not timely assumed and was therefore deemed rejected. For the first time Sears argued that 11 U.S.C. § 364 (d)(4) did not apply because the MOAC lease was not a true lease. The Court of Appeals agreed citing International Trade Admin. v. Rensselaer Polytechnic Inst., 936 F.2d 744 (2d Cir. 1991). The Court of Appeals ruled that if a lease is not creating a typical landlord-tenant relationship, it is not a true lease. The two most important factors were the length of the lease and whether all the rent was paid at the beginning of the purported lease. In the International Trade Admin. Case, the lease term was 99 years, and all the rent was paid in the first three years. The court concluded that despite the labels that the parties gave, the transaction was either a disguised sale or secured lending transaction. In Sears, based on its holding in International Trade Admin., the Court concluded that the Sears lease was not a true lease. Consequently, it held since Sears was no longer in bankruptcy, section 365 no longer applied, and the trustee was free to liquidate the liquidating trust's interest in the former Sears leasehold.

Sovereign Immunity: The King Can Do No Wrong

United States v. Miller, 2025 U.S. Lexis 1279 (March 26, 2025)

Mont. Dep’t Revenue v. Blixseth (In re Blixseth), 112 F.4th 837 (9th Cir. 2024) (petition for *cert.* pending 24-940)

U.S. vs. Miller

- Issue: Can the Internal Revenue Service be sued pursuant to 11 U.S.C. § 544(b).
- Facts: The Debtor corporation paid the insider's federal income taxes for more than two years prior to the Debtor's bankruptcy. The Trustee sued the I.R.S. to claw back those tax payments. The I.R.S. argued that the Trustee could not prevail because no creditor could have successfully sued the I.R.S. because of sovereign immunity. There was no "Golden" or "Prometheus" creditor for the Trustee to allow the Trustee to invoke 11 U.S.C. 544(b). The Trustee argued that 11 U.S.C. § 106 waives sovereign immunity not only to provide jurisdiction to sue the I.R.S. but also as to the underlying merits of the lawsuit.

History of the Case.

- The U.S. Bankruptcy Court for the District of Utah, the U.S. District Court for the District of Utah, and the Court of Appeals for the Tenth Circuit sided with the Trustee. The Court of Appeals held that the term "with respect to" found in 11 U.S.C. § 106(a) compelled the court to give the waiver of sovereign immunity its broadest interpretation.
- There was a three-to-one split in the circuits on this issue, with the majority of the courts of appeal siding with the Trustee's position.

U.S. Supreme Court Holding

- The U.S. Supreme Court reversed in an 8-to-1 opinion authored by Justice Jackson. The Court held that sovereign immunity is jurisdictional and all that 11 U.S.C. § 106(a)(1) does is to give the bankruptcy court subject matter jurisdiction. The Court noted that 11 U.S.C. §106(a)(5) makes it very clear that section 106 does not create new substantive rights not otherwise existing under Title 11 or non-bankruptcy law. Since there could be no "Golden or Prometheus Creditor" that could have avoided the payment to the I.R.S., the trustee cannot use 11 U.S.C. § 544(b) to avoid the transfer.
- Justice Gorsuch dissented.

Mont. Dep't of Revenue v. Blixseth (In re Blixseth), 112 F. 4th 827 (9th Cir. 2024) (petition for Cert. pending 24-940)

- Issue: Is 11 U.S.C. §106 as it applies to the states, unconstitutional?
- Facts: Montana conducted a tax audit of Mr. Blixseth and discovered a deficiency. Mr. Blixseth contested the finding of the auditor and appealed to the Montana State Tax Appeals Board. Rather than defend Mr. Blixseth's appeal, the state of Montana filed an involuntary petition for bankruptcy against Mr. Blixseth alleging that he owed $219,258.00. However, Montana could not prosecute a single-creditor involuntary petition against Mr. Blixseth. Montana subsequently recruited the states of Idaho and California. Montana still had an additional problem, Mr. Blixseth was contesting the debt before the State Tax Appeals Board; and, thus, its claim was subject to a bona fide dispute.

Facts

- California and Idaho quickly settled their tax claims again Mr. Blixseth. The validity of the involuntary petition dragged out for more than ten years. During the course of these proceedings, the Bankruptcy Judge asked Montana's lawyer if Montana was consenting to the jurisdiction of the Bankruptcy Court and waiving sovereign immunity? Counsel for Montana answered affirmatively that the state was consenting to the jurisdiction and waiving sovereign immunity.
- After the bankruptcy court dismissed the involuntary petition, Mr. Blixseth filed an adversary proceeding seeking damages as authorized by 11 U.S.C. § 303(i).

Court of Appeals Decision

- While the Court of Appeals conceded that if Montana filed a proof of claim, that it consented to the jurisdiction of the bankruptcy court and waived sovereign immunity. It found that involuntary petitions are different because a section 303(i) claim does not arise from the same core facts as the section 303(a) petition. It is not a compulsory counterclaim.
- Next, the Court found that the Montana's lawyer's statement regarding the consent to jurisdiction and the waiver of sovereign immunity was of no effect. Waiver of sovereign immunity must be found pursuant to Montana law.

Court of Appeals Decision (Cont'd)

- The Court next considered whether *Central Va. Cmty Coll. v. Katz*, 546 U.S. 356 (2006), provided for a waiver of sovereign immunity. The Court found that this waiver according to the plan of the constitutional convention applied to deal with (1) the exercise of exclusive jurisdiction over all of the debtor's property; (2) the equitable distribution of that property among the debtor's creditors; and (3) the ultimate discharge that gives the debtor a fresh start by releasing him or her, or it from further liability for old debts. The Court concluded that an action under 11 U.S.C. § 303(i) failed to meet any these criteria and therefore was not part of the plan of the convention.

Court of Appeals Decision (Cont'd)

- The Court then concluded that 11 U.S.C.§106 is unconstitutional because under the Court's narrow reading of *Katz*, this type of waiver in a section 303(i) proceeding was not in the plan of the convention and the states have sovereign immunity under *Han v. Louisiana*, 134 U.S.1 (1890), and arguably the Eleventh Amendment to the U.S. Constitution.
- There is a split in the circuits with the First, Second, Third and Sixth Circuits upholding the constitutionality of 11 U.S.C. § 106 and the Fourth, Fifth, Seventh, Ninth and Tenth Circuits holding the statute unconstitutional with respect to the states. Blexsith filed his brief in support of cert. on February 27, 2025.

In Pari Delicto
Unclean Hands

Kelley v. BMO Harris Bank NA, 115 F.4th 901 (8th Cir. 2024)

Aliera LT LLC, as Liquidating Trustee for the Aliera Companies, et al v. Health Reform Team, 665 B.R. 468 (Bankr. N.D. Ga 2024)

Kelley v. BMO Harris Bank

- Issue: Is a receiver who files a Chapter 11 case for his estate, immune from the defense of *In Pari Delicto*.
- Facts: Thomas J. Petters committed the second largest Ponzi scheme in the history of the United States with approximately $3.4 billion of defrauded investors.
- The U.S. District Court for the District of Minnesota appointed Douglas Kelley to be a federal equity receiver for the Petters companies. In less than a few days, Kelly put his receivership estate into bankruptcy by filing a petition under Chapter 11.

Kelley v. BMO Harris Bank

- Kelly became the bankruptcy trustee.
- BMO Harris Bank had purchased the stock of the M&I Bank in Wisconsin. M&I in turn had purchased the stock of a shopping center bank in Minnesota. The latter bank was Petters' bank. Petters ran billions of dollars of transactions through this bank.
- Many of these transactions were round trip transactions where the money would leave the bank daily and would be transferred back to the bank in a slightly different amount.

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Kelley v. BMO Harris Bank

- As the successor in interest, Kelly sued the Bank for aiding and abetting a fraud which it knew or should have known was a fraud.
- The Bank ultimately asserted the affirmative defense of *In Pari Delicto.*
- Making the case even more muddy, the Bank had destroyed back up tapes of the transactions between its predecessor and Petters.

Kelley v. BMO Harris Bank

- Holding: Kelly argued that a receiver under Minnesota state law was exempt from the defense of *In Pari Delicto*. The Court of Appeals was not so sure. But what the Court of Appeals was sure of was that even if Kelley as a receiver was exempt, as a bankruptcy trustee, he had no such immunity and the doctrine of *in pari delicto* bared the suit. The verdict was set aside and the Bank escaped liability.

The Aliera Companies.

- Issue: Should the trial court apply the doctrine of *in pari delicto*?
- Facts: This case involved a massive health care reimbursement scheme. The underlying bankruptcy case was filed in Delaware, but the adversary was filed in Atlanta, Georgia by a liquidating trustee from the Delaware case.
- The key issue is whether the doctrine of *in pari delicto* should bar the suit.

The Aliera Companies.

- Holding. The trial court recognized the doctrine of *In Pari Delicto* but, concluded that it was an equitable doctrine. The defense should be limited by what the trial court called harm to creditors.
- If application of the equitable doctrine would mean that the creditors would suffer a huge loss without a viable remedy for recovery, the Court should not apply the doctrine.
- As noted by Judge Posner, the purpose of tort law is to punish and deter wrong doers and compensate victims. Applying the doctrine of *In Pari Delicto* in this case accomplished neither goal.

Avoiding Powers

In re O'Gorman 115 F. 4th 1047 (9th Cir. 2024)

- In this case, the Ninth Circuit held that a trustee has Article III standing to bring a fraudulent transfer claim, regardless of whether the transfer actually harmed creditors. The debtor transferred real estate worth over $2.5 million to a trust to delay a foreclosure by a second-lien holder. She later filed bankruptcy. The second-lien holder's claim of $1.5 million was disallowed, because the debtor did not owe him any money. The total of all asserted unsecured claims was under $50,000.00, all of which would be paid in full. Even so, the trustee sued to avoid the transfer as a fraudulent transfer. Under Article III, to establish standing to bring the action, the trustee had to show the estate suffered a concrete, particularized injury that was likely caused by the defendant and could be redressed by the court. As representative of the estate, the trustee may bring the action on its behalf, regardless of whether there are creditors who would benefit or whether a creditor was or could have been harmed by the transfer. Actual harm to creditors is not an element of a fraudulent transfer claim. Thus, it did not matter that the creditor whose foreclosure the debtor sought to hinder, or delay was not actually entitled to foreclose and therefore was not harmed. The trustee may still pursue the fraudulent transfer claim for the benefit of the estate.

In re EPD Inv. Co., LLC, 114 F. 4th 1148 (9th Cir. 2024).

- The Debtor operated a Ponzi scheme, which involves using new investors' money to repay old investors, whether the debtor is also conducting a legitimate business or not. The trustee sued under the fraudulent transfer laws to avoid and recover transfers to an investor. Those laws require showing that the transfer was made with actual intent to hinder, delay, or defraud the debtor's creditors. The court reasoned that, by its nature, a Ponzi scheme is insolvent from its inception and is doomed to fail, and the operator is presumed to know that. From that, the court reasoned that it could infer that all transfers made by a Ponzi scheme debtor to investors were made with fraudulent intent and concluded, "In fact, 'no other reasonable inference is possible.'" The court therefore concluded that fraudulent transfer avoidance in a Ponzi scheme bankruptcy does not require an independent proof of fraudulent intent. A dissent argues otherwise.

The Curse of *Bartenwerfer vs. Buckley* 598 U.S. 69 (2023)

In re Steven Istvan CSIGI, Adv. Pro No 23-00617 (Bankr. D. Haw. Dec. 17, 2024).

- The Debtor's wife was the trustee of her mother's trust and misappropriated $858,639.00. She filed Chapter 13 petition but was denied a discharge. Her husband then filed his own Chapter 13 petition and the mother's successor trustee objected to his discharge as well. The debtor admitted that the wife used the misappropriated funds for herself, their children and for the debtor himself. The successor trustee asserted a claim for unjust enrichment against the debtor. He benefited from the defalcation. Part of the purloined funds went to settle a lawsuit in which the debtor was a defendant.
- The Court held that 11 U.S.C. § 524(a)(4), like section 524(a)(2), focuses on the debt and not the person who incurred it. The Court held that the reasoning in *Bartenwerfer vs. Buckley* 598 U.S. 69 (2023), applies to debts for defalcation as well as fraud.

GMT Mgmt Grp., LLC v. Belcher (In re Belcher), 664 B.R. 879 (Bankr. N.D. Ga. 2024).

- In this case, the Debtor and his wife filed for relief under chapter 7 of the bankruptcy code. Mrs. Belcher was involved in borrowing money to rehabilitate real estate. Mrs. Belcher signed promissory notes both in her corporate capacity and in her personal capacity. Mr. Belcher signed the notes as a guarantor. As fate would have it, Mrs. Belcher never bought any homes to rehabilitate. The Court found that Mrs. Belcher's conduct was fraudulent. Even though Mr. Belcher had signed the notes, the bankruptcy court refused to adopt the rule in *Bartenwerfer*. The court citing *In re Colquitt*, 2023 Bankr. Lexis 551 (Bankr. M.D. Ga. 2023) that because Mr. Belcher signed the notes creating a direct liability and did not engage in any fraudulent activity, *Bartenwerfer* did not apply. However, the *Belcher* case is much more like *Bartenwerfer* than *Colquitt*. The note in *Colquitt* was not part of any fraudulent scheme and Mr. Colquitt did not engage in any tortious conduct. He was a victim of a check kiting scheme. The fraudster had convinced the Debtor to advance him almost $500,000 and gave the debtor a check to repay the loan. In the meantime, the Debtor had persuaded the bank to advance that sum to the fraudster. The check scheme came crashing down to earth and the fraudster's check was dishonored leaving the bank and the Debtor holding the bag. The Debtor executed a note for almost $400,000 to repay the bank for the loss the bank had suffered.

In re Pirron, 2025 Bankr. Lexis 362, 2025 WL 53547 (Bankr. N.D. Ill. 2025).

- Issue: How should tax refunds be allocated between a debtor spouse and a non-debtor spouse?
- Facts: The husband filed for bankruptcy, but his wife did not.
- The wife received substantial income from a real estate investment firm,
- Pirron and his wife filed a joint return and were entitled to a refund of $152,356.
- Pirron had $15,585 withheld from his wages pursuant to a W-9 he lodged with his employer The wife made $577,630 in estimated payments.

In re Pirron, 2025 Bankr. Lexis 362, 2025 WL 53547 (Bankr. N.D. Ill. 2025) (con't)

- The Trustee asked for a 50/50 split of the refund.
- The bankruptcy court reviewed the various approaches. Some courts use the 50/50 rule because there is an alleged presumption that each spouse contributes equally to the family. Other courts use the income rule and consider what percentage of the income is attributable to each spouse? The court found that the majority rule is the "withholding rule." under which the refund is allocated in the same ratio as the withholding or estimated payments. Finally, some courts pretend that each debtor filed a married-filing-separate return and allocated on the basis of the overpayments reflected in each return.

In re Pirron, 2025 Bankr. Lexis 362, 2025 WL 53547 (Bankr. N.D. Ill. 2025) (con't)

- The Court did like any of the tests. Instead, the Court said that the entitlement to the refund should be determined by non-bankruptcy law If the bankruptcy had never occurred and the parties litigated that entitlement to the refund, who would win? What would a divorce court do, for example? The court concluded in the case at bar that the non-debtor wife would win and therefore gave her the entire refund