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United States Court of Appeals, First Circuit.

IN RE: the FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO, as Representative for the Commonwealth of Puerto Rico; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Highways and Transportation Authority; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Electric Power Authority (PREPA); the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Sales Tax Financing Corporation, a/k/a Cofina; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Employees Retirement System of the Government of the Commonwealth of Puerto Rico, Debtors.
Altair Global Credit Opportunities Fund (A), LLC; Andalusian Global Designated Activity Company; Glendon Opportunities Fund, LP; Mason Capital Master Fund LP; Nokota Capital Master Fund, L.P.; Oaktree-Forrest Multi-Strategy, L.L.C. (Series B); Oaktree Opportunities Fund IX, L.P.; Oaktree Opportunities Fund IX (Parallel 2), L.P.; Oaktree Value Opportunities Fund, L.P.; Ocher Rose, L.L.C.; SV Credit, L.P., Movants, Appellants,
Puerto Rico AAA Portfolio Bond Fund, Inc.; Puerto Rico AAA Portfolio Bond Fund II, Inc.; Puerto Rico AAA Portfolio Target Maturity Fund, Inc.; Puerto Rico Fixed Income Fund, Inc.; Puerto Rico Fixed Income Fund II, Inc.; Puerto Rico Fixed Income Fund III, Inc.; Puerto Rico Fixed Income Fund IV, Inc.; Puerto Rico Fixed Income Fund V, Inc.; Puerto Rico GNMA and U.S. Government Target Maturity Fund, Inc.; Puerto Rico Investors Bond Fund I, Inc.; Puerto Rico Investors Tax-Free Fund, Inc.; Puerto Rico Investors Tax-Free Fund II, Inc.; Puerto Rico Investors Tax-Free Fund III, Inc.; Puerto Rico Investors Tax-Free Fund IV, Inc.; Puerto Rico Investors Tax-Free Fund V, Inc.; Puerto Rico Investors Tax-Free Fund VI, Inc.; Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc.; Tax-Free Puerto Rico Fund, Inc.; Tax-Free Puerto Rico Fund II, Inc.; Tax-Free Puerto Rico Target Maturity Fund, Inc.; UBS IRA Select Growth & Income Puerto Rico Fund, Movants,
v.
The Financial Oversight and Management Board for Puerto Rico, as Representative for the Employees Retirement System of the Government of the Commonwealth of Puerto Rico, Debtor, Appellee,
American Federation of State County and Municipal Employees; Official Committee of Retired Employees of the Commonwealth of Puerto Rico, Movants, Appellees.
In re: the Financial Oversight and Management Board for Puerto Rico, as Representative for the Commonwealth of Puerto Rico; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Highways and Transportation Authority; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Electric Power Authority (PREPA); the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Sales Tax Financing Corporation, a/k/a Cofina; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Employees Retirement System of the Government of the Commonwealth of Puerto Rico, Debtors.
Puerto Rico AAA Portfolio Bond Fund, Inc.; Puerto Rico AAA Portfolio Bond Fund II, Inc.; Puerto Rico AAA Portfolio Target Maturity Fund, Inc.; Puerto Rico Fixed Income Fund, Inc.; Puerto Rico Fixed Income Fund II, Inc.; Puerto Rico Fixed Income Fund III, Inc.; Puerto Rico Fixed Income Fund IV, Inc.; Puerto Rico Fixed Income Fund V, Inc.; Puerto Rico GNMA and U.S. Government Target Maturity Fund, Inc.; Puerto Rico Investors Bond Fund I, Inc.; Puerto Rico Investors Tax-Free Fund, Inc.; Puerto Rico Investors Tax-Free Fund II, Inc.; Puerto Rico Investors Tax-Free Fund III, Inc.; Puerto Rico Investors Tax-Free Fund IV, Inc.; Puerto Rico Investors Tax-Free Fund V, Inc.; Puerto Rico Investors Tax-Free Fund VI, Inc.; Puerto Rico

Mortgage-Backed & U.S. Government Securities Fund, Inc.; Tax-Free Puerto Rico Fund, Inc.; Tax-Free Puerto Rico Fund II, Inc.; Tax-Free Puerto Rico Target Maturity Fund, Inc., Movants, Appellants.
Altair Global Credit Opportunities Fund (A), LLC; Andalusian Global Designated Activity Company; Glendon Opportunities Fund, LP; Mason Capital Master Fund LP; Nokota Capital Master Fund, L.P.; Oaktree Opportunities Fund IX (Parallel 2), L.P.; Oaktree Opportunities Fund IX, L.P.; Oaktree Value Opportunities Fund, L.P.; Oaktree-Forrest Multi-Strategy, L.L.C. (Series B); Ocher Rose, L.L.C.; SV Credit, L.P.; UBS IRA Select Growth & Income Puerto Rico Fund, Movants,
v.
The Financial Oversight and Management Board for Puerto Rico, as Representative for the Employees Retirement System of the Government of the Commonwealth of Puerto Rico, Debtor, Appellee,
American Federation of State County and Municipal Employees; Official Committee of Retired Employees of the Commonwealth of Puerto Rico, Movants, Appellees.
In re: the Financial Oversight and Management Board for Puerto Rico, as Representative for the Commonwealth of Puerto Rico; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Highways and Transportation Authority; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Electric Power Authority (PREPA); the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Sales Tax Financing Corporation, a/k/a Cofina; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Employees Retirement System of the Government of the Commonwealth of Puerto Rico, Debtors.
The Financial Oversight and Management Board for Puerto Rico, as Representative for the Employees Retirement System of the Government of the Commonwealth of Puerto Rico, Plaintiff, Appellee,
Official Committee of Retired Employees of the Commonwealth of Puerto Rico, Interested Party, Appellee,
v.
Altair Global Credit Opportunities Fund (A), LLC; Andalusian Global Designated Activity Company; Glendon Opportunities Fund, LP; Mason Capital Master Fund LP; Nokota Capital Master Fund, L.P.; Oaktree Opportunities Fund IX (Parallel 2), L.P.; Oaktree Opportunities Fund IX, L.P.; Oaktree Value Opportunities Fund, L.P.; Oaktree-Forrest Multi-Strategy, L.L.C. (Series B); Ocher Rose, L.L.C.; SV Credit, L.P., Defendants, Appellants,
Puerto Rico AAA Portfolio Bond Fund II, Inc.; Puerto Rico AAA Portfolio Bond Fund, Inc.; Puerto Rico AAA Portfolio Target Maturity Fund, Inc.; Puerto Rico Fixed Income Fund II, Inc.; Puerto Rico Fixed Income Fund IV, Inc.; Puerto Rico Fixed Income Fund V, Inc.; Puerto Rico Fixed Income Fund III, Inc.; Puerto Rico Fixed Income Fund, Inc.; Puerto Rico GNMA and U.S. Government Target Maturity Fund, Inc.; Puerto Rico Investors Bond Fund I, Inc.; Puerto Rico Investors Tax-Free Fund II, Inc.; Puerto Rico Investors Tax-Free Fund III, Inc.; Puerto Rico Investors Tax-Free Fund IV, Inc.; Puerto Rico Investors Tax-Free Fund V, Inc.; Puerto Rico Investors Tax-Free Fund VI, Inc.; Puerto Rico Investors Tax-Free Fund, Inc.; Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc.; Tax-Free Puerto Rico Fund II, Inc.; Tax-Free Puerto Rico Fund, Inc.; Tax-Free Puerto Rico Target Maturity Fund, Inc.; UBS IRA Select Growth & Income Puerto Rico Fund, Defendants.
In re: the Financial Oversight and Management Board for Puerto Rico, as Representative for the Commonwealth of Puerto Rico; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Highways and Transportation Authority; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Electric Power Authority (PREPA); the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Sales Tax Financing Corporation, a/k/a

Cofina; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Employees Retirement System of the Government of the Commonwealth of Puerto Rico, Debtors.
The Financial Oversight and Management Board for Puerto Rico, as Representative for the Employees Retirement System of the Government of the Commonwealth of Puerto Rico, Plaintiff, Appellee,
Official Committee of Retired Employees of the Commonwealth of Puerto Rico, Interested Party, Appellee,
v.
Puerto Rico AAA Portfolio Bond Fund, Inc.; Puerto Rico AAA Portfolio Bond Fund II, Inc.; Puerto Rico AAA Portfolio Target Maturity Fund, Inc.; Puerto Rico Fixed Income Fund, Inc.; Puerto Rico Fixed Income Fund II, Inc.; Puerto Rico Fixed Income Fund III, Inc.; Puerto Rico Fixed Income Fund IV, Inc.; Puerto Rico Fixed Income Fund V, Inc.; Puerto Rico GNMA and U.S. Government Target Maturity Fund, Inc.; Puerto Rico Investors Bond Fund I, Inc.; Puerto Rico Investors Tax-Free Fund, Inc.; Puerto Rico Investors Tax-Free Fund II, Inc.; Puerto Rico Investors Tax-Free Fund III, Inc.; Puerto Rico Investors Tax-Free Fund IV, Inc.; Puerto Rico Investors Tax-Free Fund V, Inc.; Puerto Rico Investors Tax-Free Fund VI, Inc.; Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc.; Tax-Free Puerto Rico Fund, Inc.; Tax-Free Puerto Rico Fund II, Inc.; Tax-Free Puerto Rico Target Maturity Fund, Inc., Defendants, Appellants,
Altair Global Credit Opportunities Fund (A), LLC; Andalusian Global Designated Activity Company; Glendon Opportunities Fund, LP; Mason Capital Master Fund LP; Nokota Capital Master Fund, L.P.; Oaktree Opportunities Fund IX (Parallel 2), L.P.; Oaktree Opportunities Fund IX, L.P.; Oaktree Value Opportunities Fund, L.P.; Oaktree-Forrest Multi-Strategy, L.L.C. (Series B); Ocher Rose, L.L.C.; SV Credit, L.P.; UBS IRA Select Growth & Income Puerto Rico Fund, Defendants.
In re: the Financial Oversight and Management Board for Puerto Rico, as Representative for the Commonwealth of Puerto Rico; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Highways and Transportation Authority; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Electric Power Authority (PREPA); the Financial Oversight and Management Board for Puerto Rico, as Representative for the Puerto Rico Sales Tax Financing Corporation, a/k/a Cofina; the Financial Oversight and Management Board for Puerto Rico, as Representative for the Employees Retirement System of the Government of the Commonwealth of Puerto Rico, Debtors.
Puerto Rico AAA Portfolio Bond Fund, Inc.; Puerto Rico AAA Portfolio Bond Fund II, Inc.; Puerto Rico AAA Portfolio Target Maturity Fund, Inc.; Puerto Rico Fixed Income Fund, Inc.; Puerto Rico Fixed Income Fund II, Inc.; Puerto Rico Fixed Income Fund III, Inc.; Puerto Rico Fixed Income Fund IV, Inc.; Puerto Rico Fixed Income Fund V, Inc.; Puerto Rico GNMA and U.S. Government Target Maturity Fund, Inc.; Puerto Rico Investors Bond Fund I, Inc.; Puerto Rico Investors Tax-Free Fund, Inc.; Puerto Rico Investors Tax-Free Fund II, Inc.; Puerto Rico Investors Tax-Free Fund III, Inc.; Puerto Rico Investors Tax-Free Fund IV, Inc.; Puerto Rico Investors Tax-Free Fund V, Inc.; Puerto Rico Investors Tax-Free Fund VI, Inc.; Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc.; Tax-Free Puerto Rico Fund, Inc.; Tax-Free Puerto Rico Fund II, Inc.; Tax-Free Puerto Rico Target Maturity Fund, Inc., Movants, Appellants,
Altair Global Credit Opportunities Fund (A), LLC; Andalusian Global Designated Activity Company; Glendon Opportunities Fund, LP; Mason Capital Master Fund LP; Nokota Capital Master Fund, L.P.; Oaktree Opportunities Fund IX (Parallel 2), L.P.; Oaktree Opportunities Fund IX, L.P.; Oaktree Value Opportunities Fund, L.P.; Oaktree-Forrest Multi-Strategy, L.L.C. (Series B); Ocher Rose, L.L.C.; SV Credit, L.P.; UBS IRA Select Growth & Income Puerto Rico Fund, Movants,
v.
The Financial Oversight and Management Board for Puerto Rico, as Representative for the Employees

Retirement System of the Government of the Commonwealth of Puerto Rico, Debtor, Appellee, American Federation of State County and Municipal Employees; Official Committee of Retired Employees of the Commonwealth of Puerto Rico; Official Committee of Unsecured Creditors, Movants, Appellees.

Nos. 18-1836
|
18-1837
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No. 18-1841, No. 18-1855, No. 18-1858, No. 18-1868
|
January 30, 2019

Synopsis

Background: In the debt adjustment cases of the Commonwealth of Puerto Rico and related governmental entities, including the Employees Retirement System of the Government of the Commonwealth of Puerto Rico (ERS), under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), the Financial Oversight and Management Board for Puerto Rico (FOMB), as representative of ERS, filed adversary complaint against entities that held bonds issued by ERS, seeking, inter alia, declarations concerning scope, validity, and perfection of bondholders' asserted security interest. Bondholders filed counterclaims seeking declaratory relief. The parties filed cross-motions for summary judgment. The United States District Court for the District of Puerto Rico, Laura Taylor Swain, J., sitting by designation, 590 B.R. 577, granted the Board's motion in part and denied it in part, and denied bondholders' motion. Bondholders appealed, and appeals were consolidated.

Holdings: The Court of Appeals, Lynch, Circuit Judge, held that:

the initial UCC financing statements lacked a sufficient description of collateral and, thus, did not perfect bondholders' security interest, but

under the unique circumstances presented, the financing statement amendments, read in conjunction with the initial financing statements, satisfied the filing requirements for perfection, in particular, the requirements for the "name of the debtor."

Affirmed in part, reversed in part, vacated in part, and remanded.

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF PUERTO RICO

[Hon. Laura Taylor Swain, * U.S. District Judge]

Attorneys and Law Firms

Bruce Bennett, with whom Benjamin Rosenblum, James M. Gross, Geoffrey S. Stewart, Sparkle L. Sooknanan, Parker A. Rider-Longmaid, Jones Day, Alfredo Fernández-Martínez, and Delgado & Fernández, LLC were on brief, for Altair Global Credit Opportunities Fund (A), LLC; Andalusian Global Designated Activity Company; Glendon Opportunities Fund, LP; Mason Capital Master Fund LP; Nokota Capital Master Fund, L.P.; Oaktree-Forrest Multi-Strategy, L.L.C. (Series B); Oaktree Opportunities Fund IX, L.P.; Oaktree Opportunities Fund IX, (Parallel 2), L.P.; Oaktree Value Opportunities Fund, L.P.; Ocher Rose, L.L.C; SV Credit, L.P.

Jason N. Zakia, with whom Glenn M. Kurtz, John K. Cunningham, White & Case LLP, José C. Sánchez-Castro, Alicia I. Lavergne-Ramírez, Maraliz Vázquez-Marrero, and Sanchez Pirillo LLC were on brief, for Puerto Rico AAA Portfolio Bond Fund, Inc.; Puerto Rico AAA Portfolio Bond Fund II, Inc.; Puerto Rico AAA Portfolio Target Maturity Fund, Inc.; Puerto Rico Fixed Income Fund, Inc.; Puerto Rico Fixed Income Fund II, Inc.; Puerto Rico Fixed Income Fund III, Inc.; Puerto Rico Fixed Income Fund IV, Inc.; Puerto Rico Fixed Income Fund V, Inc.; Puerto Rico GNMA and U.S. Government Target Maturity Fund, Inc.; Puerto Rico Investors Bond Fund I, Inc.; Puerto Rico Investors Tax-Free Fund, Inc.; Puerto Rico Investors Tax-Free Fund II, Inc.; Puerto Rico Investors Tax-Free Fund III, Inc.; Puerto Rico Investors Tax-Free Fund IV, Inc.; Puerto Rico Investors Tax-Free Fund V, Inc.; Puerto Rico Investors Tax-Free Fund VI, Inc.; Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc.; Tax-Free Puerto Rico Fund, Inc.; Tax-Free Puerto Rico Fund II, Inc.; Tax-Free Puerto Rico Target Maturity Fund,

Inc.; UBS IRA Select Growth & Income Puerto Rico Fund.

Jeffrey W. Levitan, with whom Timothy W. Mungovan, John E. Roberts, Michael R. Hackett, William D. Dalsen, Martin J. Bienenstock, Mark D. Harris, Kevin J. Perra, and Proskauer Rose LLP were on brief, for the Financial Oversight and Management Board for Puerto Rico, as Representative for the Employees Retirement System of the Government of the Commonwealth of Puerto Rico.

Richard B. Levin, with whom Catherine Steege, Melissa Root, Ian Heath Gershengorn, Lindsay C. Harrison, William K. Dreher, Robert Gordon, Richard Levin, Jenner & Block LLP, A.J. Bennazar-Zequeira, and Bennazar, García, & Milián, C.S.P. were on brief, for the Official Committee of Retired Employees of the Commonwealth of Puerto Rico.

Michael Shih, Appellate Division, Civil Staff, Joseph H. Hunt, Assistant Attorney General, Mark R. Freeman, and Michael S. Raab, Appellate Division, Civil Staff, for the United States, amicus curiae.

Before Lynch, Stahl, and Kayatta, Circuit Judges.

Opinion

LYNCH, Circuit Judge.

***1** These appeals involve bonds issued in 2008 by the Employees Retirement System of the Government of the Commonwealth of Puerto Rico [1] (the "System"), which were bought by bondholders (the "Bondholders"), the appellants here. The bond documentation offered as security certain property belonging or owed to the System, as defined in a "Pension Funding Bond Resolution." The Bondholders claim that they have a perfected security interest in that property under Puerto Rico's version of the Uniform Commercial Code ("UCC").

Through the Financial Oversight and Management Board for Puerto Rico (the "Oversight Board"), the System filed suit in the district court on July 21, 2017, seeking declaratory judgments on several issues related to the validity, breadth, and perfection of the Bondholders' asserted security interest, and regarding the System's compliance with a stipulation between the parties (the "January 2017 Stipulation"). The Bondholders brought nine counterclaims concerning their asserted security interest as well as an alleged violation of the January 2017 Stipulation. After both sides moved for summary judgment, the district court ruled in favor of the System, finding that the Bondholders' interest was not perfected and so could be avoided under 48 U.S.C. § 2161(a), that there had been no violation of the January 2017 Stipulation, and that two of the Bondholders' counterclaims should be dismissed with prejudice. The Fin. Oversight and Mgmt. Bd. for P.R. v. Altair Glob. Credit Opportunities Fund (a), LLC (In re: The Fin. Oversight and Mgmt. Bd. for P.R.), 590 B.R. 577 (D.P.R. 2018). We are told the dollar value of the security for the bonds at stake is about $2.9 billion. The Bondholders appealed.

We agree with the district court on the particular facts here that the UCC financing statements filed in 2008 (the "2008 Financing Statements") did not perfect the Bondholders' security interest, as they lacked a sufficient description of collateral. But we find that the financing statement amendments filed in 2015 and 2016 (together, the "Financing Statement Amendments") satisfied the filing requirements for perfection when read in conjunction with the 2008 Financing Statements. We reverse the district court's determination on the satisfaction of filing requirements for perfection by amendment, and hold that the Bondholders satisfied the filing requirements for perfection as of December 17, 2015.

Because the Bondholders' security interest was perfected, this interest cannot be avoided under the Puerto Rico Oversight, Management, and Economic Stability Act's ("PROMESA") incorporation of parts of the Bankruptcy Code, including 11 U.S.C. § 544(a), and so we do not reach the issue of whether PROMESA and other relevant Commonwealth law would allow for the retroactive avoidance of unperfected liens. [2] Accordingly, we vacate the district court's holding on avoidance of the Bondholders' security interest. We vacate the dismissal of two of the Bondholders' counterclaims and remand to the district court for further proceedings in light of this opinion. Finally, we affirm the dismissal of the Bondholders' claim regarding the January 2017 Stipulation.

***2** As to the first issue, concerning the 2008 Financing Statements alone, we decide narrowly on the particular facts presented. As to the issue of perfection by amendment, also narrowly decided, this case presents a unique confluence of circumstances involving two

languages and a translation, particularly regarding the sufficient name of the System under Article 9 of the UCC (Secured Transactions), as adopted by the Commonwealth. Puerto Rico recognizes two official statutory languages. P.R. Laws Ann. tit. 1, § 59. We face a statutory amendment from 2013 (officially translated in 2014) that variously uses two English terms when translating the same unvaried Spanish term for the name of the System. Id. tit. 3, §§ 761, 763. Further, past official translations, and the System itself, have consistently used the ERS name (including in many court filings) for over sixty years. We craft our holding narrowly to accommodate the very unusual circumstances presented by a new translation that is, on its face, inconsistent, that varies from every other formal version both before and after its presentation, and that arises in a context in which there is no realistic likelihood that anyone would search the Department of State of the Government of Puerto Rico's (the "P.R. Department of State") records only under one of the two forms of the name that appear in the English translation of the amended statute.

I.

The System is a trust and government agency created in 1951 by an Act of the Commonwealth. Law No. 447 of May 15, 1951, 1951 P.R. Laws 1298 (the "1951 Enabling Act") (codified as amended at P.R. Laws Ann. tit. 3, §§ 761 et seq.). The System is structured to provide pensions and other retirement benefits to employees and officers of the Commonwealth government, members and employees of the Commonwealth's Legislative Assembly, and officers and employees of the Commonwealth's municipalities and public corporations. P.R. Laws Ann. tit 3, § 764. It is designated as "independent and separate" from other Commonwealth agencies. Id. § 775. Until legislation that went into effect on July 1, 2017, the System was funded by mandatory contributions from employees and employers, and by the System's investment earnings. See Concurrent Resolution 188 of the House of Representatives of the Government of Puerto Rico; Law No. 106 of August 23, 2017.

As of 2008, the Enabling Act allowed the System to incur debt when the Board of Trustees of the System so authorized. P.R. Laws Ann. tit. 3, § 779(d) (2008). Seeking to decrease an unfunded liability of approximately $9.9 billion, the Board of Trustees adopted a "Pension Funding Bond Resolution" (the "Resolution") on January 24, 2008. The Resolution allowed for the issuance of about $2.9 billion in bonds. The Resolution was made publicly available on several governmental websites, including on the Government Development Bank for Puerto Rico's website and on the System's own website.

The Bondholders hold some of those bonds issued by the System. The System executed a security agreement (the "Security Agreement"), which purports to grant the Bondholders a security interest in "Pledged Property" belonging or owed to the System. "Pledged Property" was defined in the Resolution but not in the Security Agreement. The Resolution's definition included the required employer contributions to the System and proceeds from these contributions.[3] The Security Agreement did not itself define or otherwise describe "Pledged Property." Rather, it stated that "[a]ll capitalized words not defined herein shall have the meaning ascribed to them in the Resolution." But the Resolution was not attached to the Security Agreement, and the Security Agreement did not even say what types of property were pledged, whether the Resolution was available to the public, or where the Resolution could be found.

***3** Security interests could be perfected by filing financing statements comporting with the requirements of Article 9 of the UCC, as adopted by the Commonwealth. In 2008, those requirements included, among other things, that a financing statement "contain[ ] a statement indicating the types, or describing the items, of collateral." P.R. Laws Ann. tit. 19, § 2152(1) (2008).

The Security Agreement specified that "[the System] shall cause UCC financing and continuation statements to be filed, as appropriate, and the Secured Party shall not be responsible for any UCC filings." On or about June 24, 2008, and July 2, 2008,[4] two financing statements (the 2008 Financing Statements) related to the System's bonds, as described above, were filed with the P.R. Department of State. The 2008 Financing Statements each used a standard "Financing Statement" form provided by the P.R. Department of State, where such statements are located. Initial financing statements are sometimes referred to as "UCC-1" statements.

The 2008 Financing Statements described the collateral as "[t]he pledged property described in the Security

Agreement attached as Exhibit A hereto and by reference made a part thereof." The Security Agreement, Exhibit A, was attached to each of the 2008 Financing Statements as filed but, as said, did not itself describe the "Pledged Property" except as it purported to do by reference to an unattached other document. That is, the Resolution, which contained the full definition of "Pledged Property" and other key terms, was not attached. The 2008 Financing Statements do not otherwise describe or define the "Pledged Property" (meaning the collateral). In short, the documents filed with the P.R. Department of State described the collateral only by stating that it was "Pledged Property" described in a document that could only be found somewhere outside the P.R. Department of State.

Between the filing of the 2008 Financing Statements and the filing of the Financing Statement Amendments in 2015 and 2016, the Commonwealth repealed its earlier version of Article 9 of the UCC and enacted a revised version, Law No. 21 of January 17, 2012, 2012 P.R. Laws 162 (codified at P.R. Laws Ann. tit. 19, §§ 2211-2409). The updated law went into effect on January 17, 2013, one year after its approval. (See P.R. Laws Ann. tit. 19, § 2211). The new version of Article 9 made modest changes to the requirements for financing statements, and made the effective life of financing statements five years rather than ten years.

On or about December 17, 2015, and January 16, 2016, the four Financing Statement Amendments were filed. These filings all used a standard "Financing Statement Amendment" form provided by the P.R. Department of State. The Financing Statement Amendments describe the collateral as "[t]he Pledged Property and all proceeds thereof and all after-acquired property as described more fully in Exhibit A attached hereto and incorporated by reference." Unlike the 2008 Financing Statements, Exhibit A contained a full definition of "Pledged Property" drawn from the Resolution. The Financing Statement Amendments provide, in the attached Exhibit A, that the debtor is the "Employees Retirement System of the Government of the Commonwealth of Puerto Rico." That naming of the debtor is at issue in the argument concerning whether the Financing Statement Amendments sufficed to satisfy the filing requirements for perfection. [5]

***4** The P.R. Department of State certified in March 2017 that a search of the Commonwealth's UCC records under the name "Employees Retirement System of the Government of the Commonwealth of Puerto Rico" revealed the 2008 Financing Statements and the Financing Statement Amendments. A copy of a UCC search report from October 17, 2017, for a search performed by Wolters Kluwer on behalf of the Bondholders, indicates the same. None of the 2008 Financing Statements and the Financing Statement Amendments had been removed from the P.R. Department of State's records as of October 2017.

After the filing of the 2008 Financing Statements and before the filing of the Financing Statement Amendments, the Commonwealth's legislature amended the Enabling Act in 2013. Law No. 3 of April 4, 2013, 2013 P.R. Laws 39 (codified at P.R. Laws Ann. tit 3, § 761 et seq.). From the original Enabling Act in 1951 until 2014, the English translation of the Enabling Act, as codified, used "Employees Retirement System" as the first part of the name of the System, when translating the Spanish term "Sistema de Retiro de los Empleados." Compare Law No. 447 of May 15, 1951, 1951 P.R. Laws 1298 (English, "Employees Retirement System") with id. at 1299 (Spanish, "Sistema de Retiro de Los Empleados"). The legislature had amended the Enabling Act numerous times before 2013, including changing the name of the System in 2004 by removing "and its Instrumentalities" and by replacing "Government of Puerto Rico" with "Government of the Commonwealth of Puerto Rico." See P.R. Laws Ann. tit. 3, § 761 (2006). But the English translation of the System as, in part, "Employees Retirement System," remained the same. See P.R. Laws Ann. tit. 3, § 761 (2011); P.R. Laws Ann. tit. 3, § 761 (2006); P.R. Laws Ann. tit. 3, § 761 (1988).

The English language translation of the 2013 amended Enabling Act was published on February 28, 2014, more than ten months after the 2013 Act's April 4, 2013, approval in Spanish and about seven months after its effective date. [6] As codified, the translation refers to the System as both "Retirement System for Employees of the Government of the Commonwealth of Puerto Rico" and "Employees Retirement System of the Government of the Commonwealth of Puerto Rico." P.R. Laws Ann. tit. 3, §§ 761, 763(36). In many sections, the translation of the Enabling Act continues to use the prior version of the English name ("Employees Retirement System of the Government of the Commonwealth of Puerto Rico").

Such continuity in the translation carries over to the "Statement of Motives" section and to the definition of the shorthand "System," as well as to dozens of other sections. In Section 1-10, which describes how the System was "to be designated," the translation uses the English formulation, "Retirement System for Employees of the Government of the Commonwealth of Puerto Rico" for the unchanged Spanish original, "Sistema de Retiro de los Empleados del Gobierno del Estado Libre Asociado de Puerto Rico." Law No. 3 of April 4, 2013, 2013 P.R. Laws 64.

Months after the Financing Statement Amendments were filed in late 2015 and early 2016, Congress enacted PROMESA, 48 U.S.C. § 2101 et seq., on June 30, 2016. Among other things, PROMESA created the Oversight Board and granted the Board a range of powers over the Commonwealth's finances, see, e.g., id. §§ 2121-2129, including the general mandate to craft "a method [for the Commonwealth] to achieve fiscal responsibility and access to the capital markets," id. § 2121(a).

***5** PROMESA incorporated by reference certain provisions of the Bankruptcy Code, id. § 2161(a), including the "strong-arm" provision at 11 U.S.C. § 544(a).[7] That provision "set[s] out the circumstances under which a trustee" may permissibly "pursue avoidance" of certain interests. Merit Mgmt. Grp., LP v. FTI Consulting, Inc., —— U.S. ——, 138 S.Ct. 883, 888, 200 L.Ed.2d 183 (2018).

Pursuant to Section 301(c)(7) of PROMESA, the Oversight Board is the "trustee" as that term is defined in the Bankruptcy Code (except under one circumstance that is not relevant here, see 11 U.S.C § 926). 48 U.S.C. § 2161(c)(7). PROMESA also provides that "Subchapters III and VI shall apply with respect to debts, claims, and liens ... created before, on, or after [June 30, 2016]." Id. § 2101(b)(2).

PROMESA's enactment triggered an automatic temporary stay, under Section 405, on creditors' remedies against the Commonwealth and its property. Id. § 2194(a)-(b). The Bondholders moved to lift that stay, but that motion was denied by the district court. See Peaje Invs. LLC v. García-Padilla, 845 F.3d 505, 510 (1st Cir. 2017). This court vacated the district court's decision in part and remanded for further proceedings, id. at 516, and expressed general concerns with the protection afforded for the Bondholders' property, id. at 511-12.

On remand, the System and the Bondholders entered into the January 2017 Stipulation, in order to resolve Altair Global Credit Opportunities Fund (A), LLC v. García-Padilla, No. 16-cv-2696. The January 2017 Stipulation required, in relevant part, that "Employers' Contributions (as defined in the ERS Bond Resolutions) received by the ERS during the pendency of the stay imposed pursuant to [PROMESA] § 405 shall be transferred by the ERS to [a segregated account] for the benefit of the holders of the ERS bonds."

On May 3, 2017, the Oversight Board filed a petition under Title III of PROMESA on behalf of the Commonwealth. On May 21, 2017, the Oversight Board filed a Title III petition on behalf of the System, which triggered an automatic stay of litigation against the System. The Bondholders moved to lift the stay, and the parties entered into a Joint Stipulation that resolved the Bondholders' motion. The Joint Stipulation stated that an adversary proceeding would be filed by the System on or before July 21, 2017, and limited the scope of the proceeding to the "validity, priority, extent and enforceability" of the Bondholders' claimed security interest and the System's rights regarding employer contributions received during May 2017, as well as relevant counterclaims by the Bondholders.

***6** On July 21, 2017, the System, through the Oversight Board, brought this case in federal district court against the Bondholders, seeking declarations about the status, scope, and validity of the Bondholders' claimed security interest in the "Pledged Property," and about the System's compliance with the January 2017 Stipulation. See In re: Fin. Oversight & Mgmt. Bd. for P.R., 590 B.R. at 583.[8] The Bondholders asserted nine counterclaims, requesting declarations concerning their asserted security interest as well as an alleged violation of the January 2017 Stipulation.

The parties both moved for summary judgment. Id. The System sought judgment in its favor on its four claims; the Bondholders sought the dismissal of all of the System's claims as well as judgment in their favor on all of their counterclaims. Id.

On August 17, 2018, the district court granted the System's motion for summary judgment in part and denied the Bondholders' cross-motion in its entirety. Id. at 599-600. The district court held that any security interest the Bondholders might possess had not been perfected by the 2008 Financing Statements, because those Statements did not contain an adequate description of the collateral as required under Article 9 in 2008. Id. at 589 (citing P.R. Laws Ann. tit. 19, § 2152(1) (2008)). The district court then determined that the Financing Statement Amendments did not perfect the Bondholders' security interest, because they did not identify the debtor by its correct legal name, which the court determined was the RSE name, as the court felt was required by the version of Article 9 operative in 2015 and 2016. Id. at 592 (citing P.R. Laws Ann. tit. 19, § 2322(a)(1)).

Starting from the determination that the Bondholders' interest was unperfected when the Title III case began, the district court then held that the Oversight Board, as trustee, could avoid the liens under the strong-arm provision at 11 U.S.C. § 544(a), which PROMESA incorporates, see 48 U.S.C. § 2161(a). In re: Fin. Oversight & Mgmt. Bd. for P.R., 590 B.R. at 592-98. That is, Commonwealth law did not prevent a hypothetical creditor from obtaining a judgment lien against the System's assets at the time when the Title III case commenced. Id. at 594. The district court thus invalidated the Bondholders' interests pursuant to Section 544(a). The district court then held that the System did not violate the January 2017 Stipulation because the adversary proceedings were limited to claims or counterclaims related to employer contributions received during May of 2017, and the System's obligation to transfer such funds to a segregated account clearly ended with the PROMESA stay on May 1, 2017. Id. at 599.

Following a joint response to an order to show cause as to why the Bondholders' counterclaims One through Four "ought not to be dismissed for failure to state a claim upon which relief may be granted," the district court dismissed the Bondholders' counterclaims with prejudice on September 5, 2018.

***7** The Bondholders timely appealed, and this court granted motions to consolidate these appeals.

II.

This case comes on summary judgment. In reviewing grants of summary judgment, "we take as true the facts documented in the record below, resolving any factual conflicts or disparities in favor of the nonmovant." Colt Def. LLC v. Bushmaster Firearms, Inc., 486 F.3d 701, 705 (1st Cir. 2007). Nearly all of the operative facts are undisputed here, and the grant of summary judgment turns primarily on interpretations of law, which this court reviews de novo, or mixed questions of law and fact, for which "we employ a degree-of-deference continuum, providing non-deferential plenary review for law-dominated questions and deferential review for fact-dominated questions." Johnson v. Bos. Pub. Sch., 906 F.3d 182, 191 (1st Cir. 2018) (internal quotation marks omitted).

We first consider perfection by the 2008 Financing Statements on their own, and then in conjunction with the later Financing Statement Amendments, before briefly considering avoidance under PROMESA. We then address the dismissal of two of the Bondholders' counterclaims and the alleged violation of the January 2017 Stipulation.

A. Perfection by the 2008 Financing Statements

The Bondholders argue that the initial 2008 Financing Statements perfected their security interest. Under the former version of Article 9 operative in 2008,

> [a] financing statement is sufficient if it [1] gives the names of the debtor and the secured party, [2] is signed by the debtor, [3] gives an address of the secured party from which information concerning the security interest may be obtained, [4] gives a mailing address of the debtor and [5] contains a statement indicating the types, or describing the items, of collateral.

P.R. Laws Ann. tit. 19, § 2152(1) (2008). There is no dispute that the 2008 Financing Statements met the first

four requirements at the time they were filed, and so those elements are not considered here. We also stress that the validity of the underlying Security Agreement is not at issue. Security agreements are private contracts between parties and do not have the same public notice purpose as financing statements. See Webb Co. v. First City Bank (In re Softalk Publ'g Co., Inc.), 856 F.2d 1328, 1330 (9th Cir. 1988). Instead, our discussion is limited only to whether the 2008 Financing Statements "contain[ ] a statement indicating the types, or describing the items, of collateral," as required by the then-existing statute. See P.R. Laws Ann. tit. 19, § 2152(1) (2008).

The Bondholders argue that we should adopt a lenient understanding of the collateral description requirement, such that the mere reference in the Security Agreement to the definition of "Pledged Property" contained in a separate document, the Resolution, constituted a sufficient description, even though the Resolution, and thus its description of "Pledged Property," was not attached to the 2008 Financing Statements. The Bondholders cite a number of cases to argue that incorporation by reference is appropriate in this situation. They argue this is in part because the collateral description in a financing statement is, in their view, only "a starting point" in providing notice to an interested party. John Deere Co. of Balt. v. William C. Pahl Constr. Co., 34 A.D.2d 85, 88, 310 N.Y.S.2d 945 (1970).

***8** The System, joined by the Committee of Retired Employees of the Commonwealth of Puerto Rico (the "Committee") by reference in its brief, counters that the UCC's goals, like public notice, require a strict rule that interested parties should not face the burden and potential risks of further searching for a collateral description not found within or appended to a financing statement.

We clear away some arguments which are beside the point. It is not helpful for the parties to use terms such as "liberal" or "strict" construction of Article 9. And it is likely that on some facts, incorporation by reference was permissible under the version of Article 9 operative in the Commonwealth when the 2008 Financing Statements were filed. That principle is not really at issue. On the facts on this record, we, like the district court, conclude that the 2008 Financing Statements were insufficient to perfect the security interest under P.R. Laws Ann. tit. 19, § 2152(1) (2008). [9] There has been no literal compliance with this rule, and this provision should be interpreted consonant with the goals of the UCC.

Our holding of an insufficient collateral description depends heavily on the facts, where a) the collateral is not described, even by type(s), in the 2008 Financing Statements or attachments; b) the 2008 Financing Statements do not tell interested parties where to find the referenced document (the Resolution) which contains the fuller collateral description; and c) the Resolution is not at the UCC filing office.

First, the 2008 Financing Statements do not describe even the type(s) of collateral, much less the items, at issue. Cf. Elf Atochem N. Am., Inc. v. Celco, Inc., 187 Ariz. 89, 927 P.2d 355, 363 (Ariz. Ct. App. 1996) (finding sufficient a financing statement that described the collateral as "equipment," as further described in two specific but unattached sales orders). They also do not attach the document (the Resolution) referenced as describing the collateral. Nor do those facts alone define the issue before us. In addition, the referenced document -- the Resolution -- was held in a different location from the UCC filing office, and the 2008 Financing Statements (including the attached Security Agreement) contain no indication of the referenced document's location or how to find it.

This total combination of facts undercuts several key goals of the UCC and its filing system. These goals include fair notice to other creditors and the public of a security interest. See UCC § 9-502 cmt. 2; [10] Wheeling & Lake Erie Ry. Co. v. Keach (In re: Montreal, Me. & Atl. Ry., Ltd.), 799 F.3d 1, 11 (1st Cir. 2015) ("[A] primary goal of both Article 9 and ... perfection rules is to ensure that other creditors have notice of [a] security interest."); In re Softalk Publ'g Co., 856 F.2d 1328, 1330 (9th Cir. 1988) ("The [UCC] financing statement serves to give notice to other creditors or potential creditors that the filing creditor might have a security interest in certain assets of the named debtor."); In re Cushman Bakery, 526 F.2d 23, 28 (1st Cir. 1975) (stating that "the system of notice filing is designed to ... apprise creditors that the secured party may have a security interest in the collateral described in the financing statement"). [11] Article 9 was also meant to facilitate the expansion of commercial practices. See P.R. Laws Ann. tit. 19, § 401(2). [12]

***9** Here, as said, the 2008 Financing Statements do not describe even the type(s) of collateral; instead, they describe the collateral only by reference to an extrinsic document located outside the UCC filing office, and that document's location is not listed in the financing statement. This at best gives an interested party notice about an interest in some undescribed collateral, but does not adequately specify what collateral is encumbered. That is, an interested party knowing nothing more than this does not have "actual knowledge" and has not "received a notice," see P.R. Laws Ann. tit. 19, § 451(25)(a)-(b) (2008), of the collateral at issue. Requiring interested parties to contact debtors at their own expense about encumbered collateral, with no guarantee of a timely or accurate answer, would run counter to the notice purpose of the UCC. [13] See, e.g., In re Quality Seafoods, Inc., 104 B.R. 560, 561 (Bankr. D. Mass. 1989).

The UCC filing requirements are clear. See Uniroyal, Inc. v. Universal Tire & Auto Supply Co., 557 F.2d 22, 23 (1st Cir. 1977). It would not have been difficult whatsoever for the 2008 Financing Statements to provide proper notice. The Resolution could simply have been attached to these filings, as the Security Agreement was. Instead, as they stand, the 2008 Financing Statements would leave a reasonable creditor or interested party with doubts as to the collateral at issue. We do not interpret the former UCC provision in a way contrary to its purposes, above all notice, and so the description of collateral in the 2008 Financing Statements was insufficient.

Having resolved the logically antecedent question concerning the first UCC filings, we turn to the amendment issues.

B. Lapse of 2008 Financing Statements

The System and the Committee argue that the 2008 Financing Statements could not later satisfy the requirements for perfection, by amendment, because the 2008 Financing Statements had lapsed by the time the Financing Statement Amendments were filed in 2015 and 2016. The Commonwealth's enactment of a revised Article 9, they argue, shortened the effective time period of an initial financing statement from ten years to five years. Compare P.R. Laws Ann. tit. 19, § 2335(a) (five years) with id. § 2153(2) (2008) (ten years). Here, the Financing Statement Amendments were filed about seven and a half years after the 2008 Financing Statements. Because lapsed financing statements are ineffective, see P.R. Laws Ann. tit. 19, § 2335(c), the Committee argues that the Amendments filed by the Bondholders could not have cured the deficiencies as to the collateral description in the 2008 Financing Statements. In support of their view, the System and the Committee primarily point to a transition provision, the "Savings clause," in the revised Article 9, which states that "[e]xcept as otherwise provided in this subchapter, this act applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before this act takes effect." Id. § 2402(a).

This argument on lapse fails for several reasons. First, as to retroactivity, this Savings clause is not intended to apply to the separate provision that shortened the life of financing statements on its effective date. The Commonwealth's Law 17 of 2014, which clarified that the effective time period of financing statements was five years, does not contain a statement concerning retroactivity. See Law No. 17 of January 16, 2014. And as a textual matter, we would expect that a provision intended to apply retroactively to financing statements would directly mention financing statements, particularly given the Commonwealth's longstanding requirement that a law must "expressly so decree" in order to have retroactive effect. P.R. Laws Ann. tit. 31, § 3.

***10** Second, the P.R. Department of State, where UCC filings are made, considered the amendment to the time period "for the life of an initial financing statement" and concluded that the decrease to five years "cannot be retroactive." P.R. Dept. of State, Circular 2014-01, Clarifications on Term for Filing Continuing Financing Statements Based on Law 17-2014 (Jan. 24, 2014) (English trans.). That is, "for initial financ[ing] statements filed on or before January 15, 2014, [the] term is ten (10) years." Id. [14] Though this Circular does not have the force of law, it is informative on this issue. Consistent with this Circular, the Filing Office did not refuse to accept the Financing Statement Amendments, as it would have been required to do if the 2008 Financing Statements had lapsed. See P.R. Laws Ann. tit. 19, § 2336(b)(3)(B)(ii).

Third, our conclusion comports with P.R. Laws Ann. tit. 31, § 3, the general provision of the Commonwealth's Civil Code, which states that "[i]n no case shall the retroactive effect of a law operate to the prejudice of rights acquired under previous legislative action." [15] Acceptance of the System's position would run afoul of this provision. The

enactment of the old Article 9 into Commonwealth law was clearly a legislative action. Applying the five-year rule retroactively would harm the rights of creditors holding perfected security interests through initial financing statements that were between five and ten years old on January 16, 2014, the effective date of the modified rule. See id. tit. 19, § 2335(a). Nothing in the law on the effective time limit for financing statements suggests treating financing statements differently depending on perfection, and instead refers broadly to "a filed financing statement" and the "date of filing," id. (emphasis added). So, the bar on retroactivity protects all filers in the time period at issue (which includes the Bondholders in this case).

The 2008 Financing Statements had not lapsed when the Financing Statement Amendments were filed about seven and a half years later, because the ten-year rule applied to the 2008 Financing Statements.

C. Perfection by the Financing Statement Amendments in Conjunction with the 2008 Financing Statements

We next consider whether the Financing Statement Amendments cured defects in the initial Statements, when these filings are read together. See, e.g., P.R. Laws Ann. tit. 19, § 2404(3)(B); see also Miami Valley Prod. Credit Ass'n v. Kimley, 42 Ohio App.3d 128, 536 N.E.2d 1182, 1186 (Ohio Ct. App. 1987) ("We are willing to treat the two financing statements as a single financing statement ...."). We do not reach the Bondholders' alternative argument that the Financing Statement Amendments independently perfected their security interest, since we determine that the Financing Statement Amendments cured defects in the 2008 Financing Statements. Similarly, we do not reach the Bondholders' argument that Section 2323 allows the use of "other name[s]" of a debtor, see P.R. Laws Ann. tit. 19, § 2323(b)(1), as this would require a broader consideration of aspects of Article 9 that are beyond the necessary scope of this case.

***11** Article 9 contemplates situations where a financing statement amendment "cures" an earlier financing statement by fixing outdated or incorrect information in the financing statement, such as after a name change by a debtor. See, e.g., id. § 2327(c). Under Article 9, "[a] security interest ... (3) becomes perfected ... (B) when the applicable requirements for perfection are satisfied." Id. § 2404(3)(B). As to these "applicable requirements," a financing statement is sufficient only "if it: (1) Provides the name of the debtor; (2) provides the name of the secured party or a representative of the secured party, and (3) indicates the collateral covered by the financing statement." Id. § 2322(a). We now consider the Bondholders' compliance with these requirements in the 2008 Financing Statements and the Financing Statement Amendments.

1. Name of the Secured Party and Collateral Description

The Financing Statement Amendments sufficiently provide the name of the secured party's agent in Exhibit A: "The Bank of New York Mellon, as Fiscal Agent," as required under Section 2322(a)(2). [16] No party disputes this clear point.

As to the collateral description requirement, under the new Article 9, a collateral description of personal property is sufficient "whether or not it is specific, if it reasonably identifies what is described," id. § 2218(a), but a "[s]upergeneric description [is] not sufficient," id. § 2218(c). One of the "[e]xamples of reasonable identification," id. § 2218(b), under Article 9 is a "[s]pecific listing" of the collateral, id. § 2218(b)(1).

Here, the Financing Statement Amendments described the collateral as "[t]he Pledged Property and all proceeds thereof and all after-acquired property as described more fully in Exhibit A attached hereto and incorporated by reference." Exhibit A, in turn, contained a detailed definition of "Pledged Property." [17] Each of the relevant capitalized terms in the definition of "Pledged Property" -- "Revenues," "Funds," "Accounts," "Subaccounts," "Fiscal Agent," "Debt Service Reserve Account," and "Resolution" -- is also defined in Exhibit A. The definition of "Pledged Property" satisfied one of the "[e]xamples of reasonable identification" by providing a "[s]pecific listing" of the collateral. Id. It therefore suffices as a description of collateral.

2. Name of the Debtor

We now turn to the key question of whether the Financing Statement Amendments contain a sufficient "name of the debtor." Article 9 contains different requirements for the names of registered organizations and for the names of individuals. A "[r]egistered organization" is defined, in

part, as "an organization organized solely under the law of a single state or the United States by the filing of a public organic record with, the issuance of a public organic record by, or the enactment of legislation by the state or United States." Id. § 2212(a)(71). The System is a registered organization because it is an organization formed and organized by the Commonwealth's enactment of legislation: the 1951 Enabling Act. When a debtor is a registered organization,

> [a] financing statement sufficiently provides the name of the debtor ... only if the financing statement provides the name that is stated to be the registered organization's name on the public organic record most recently filed with or issued or enacted by the registered organization's jurisdiction of organization which purports to state, amend, or restate the registered organization's name.

Id. tit. 19, § 2323(a)(1). Though a financing statement that "provides only the debtor's trade name does not sufficiently provide the name of the debtor," id. § 2323(c), an otherwise sufficient financing statement, containing a correct name of the debtor, is "not rendered ineffective by the absence of ... [a] trade name or other name of the debtor," id. § 2323(b). [18]

***12** Like the 2008 Financing Statements, Exhibit A to the Financing Statement Amendments stated the name of the debtor as "Employees Retirement System of the Government of the Commonwealth of Puerto Rico." The 2008 Financing Statements also stated the "[e]ntity name" of the debtor as "Employees Retirement System of the Government of the Commonwealth of Puerto Rico." The System and the Committee argue that, as of February 28, 2014, this became the incorrect name because, in their view, the English translation of the 2013 amendment to the Enabling Act changed the System's English name. Id. tit. 3, § 761. The English translation of that Act states that "[a] retirement and benefit system to be designated as the 'Retirement System for Employees of the Government of the Commonwealth of Puerto Rico' ... is hereby created." Law No. 3 of April 4, 2013, 2013 P.R. Laws 64. In the System's view, the 2013 amendment to the Enabling Act is the relevant "public organic record most recently filed with or issued or enacted by the registered organization's jurisdiction of organization." P.R. Laws Ann. tit. 19, § 2323(a)(1). The System argues that Section 1-101, codified at P.R. Laws Ann. tit. 3, § 761, alone is the section which "state[s]" the name of the System under Section 2323(a)(1), and so concludes that the RSE name is the name for Article 9 purposes. That is, the System argues that it is irrelevant that other sections of the Act use "Employees Retirement System," see, e.g., id. § 763(36), because only Section 1-101 of the translation "purports to state, amend, or restate the registered organization's name," id. tit. 19, § 2323(a)(1). Even if this were a translation error, the System argues, "that erroneous translation would nevertheless constitute [the System's] name for Article 9 purposes." The System argues that any UCC filing (whether a financing statement or financing statement amendment) under "Employees Retirement System of the Government of the Commonwealth of Puerto Rico" does not state the correct name. On this view, because a search under the correct name -- "Retirement System for Employees of the Government of the Commonwealth of Puerto Rico" -- would not find such a UCC filing, use of the ERS name is seriously misleading. P.R. Laws Ann. tit. 19, § 2326(c).

The Bondholders make numerous arguments in opposition regarding the sufficiency of the name used, some statutory and some focused on the System's own conduct. We do not detail those arguments further, but deal with them in our analysis.

We resolve the merits of this matter on the record, which is adequate. Both the 2008 Financing Statements and the Financing Statement Amendments were filed in English. And so we look to the 2014 English translation of the Enabling Act to determine whether the Financing Statement Amendments comply with the UCC's reference to the "public organic record most recently ... enacted by the [System's] jurisdiction of organization which purports to state, amend, or restate the [System's] name." P.R. Laws Ann. tit. 19, § 2323(a)(1). The "to be designated as" language codified at Section 761 does not mean that no other portion of the statute "state[s]" the name of the System for UCC purposes. The System misconstrues the relevant UCC provision here, by suggesting that only the first section of the Enabling Act "purports to state, amend, or restate the registered organization's name,"

id. tit. 19, § 2323(a)(1), because that section uses the following language: "A retirement and benefit system to be designated as the 'Retirement System for Employees of the Government of the Commonwealth of Puerto Rico,' ... is hereby created." Id. tit. 3, § 761. The requirement is that a filer "provide the name that is stated" in the "public organic record ... which purports to state, amend, or restate the registered organization's name." Id. (emphasis added). The latter clause, starting with "which purports," plainly modifies "public organic record." So, it does not follow that only one of many clauses in the statute must be all that can be considered when determining what "name ... is stated" in the "public organic record." [19] Instead, this UCC provision directs focus to the entire "public organic record which purports to state, amend, or restate the registered organization's name." Id. The fact that Section 1-101 of the English translation of the amended Enabling Act uses "Retirement System for Employees of the Government of the Commonwealth of Puerto Rico" does not end the inquiry.

***13** The official English translation, on its face, repeatedly translates the exact same Spanish name in two different ways. [20] Both "Retirement System for Employees" and "Employees Retirement System," are used, seemingly interchangeably, throughout the translated Act as codified. No provision of the Act states, nor even suggests, that the ERS name is used as a trade name or nickname rather than an official, legal name. [21] We do not agree with the System that one English name (the RSE name) is official and the other (the ERS name) is merely a trade name, which would be insufficient.

The System's argument that the "to be designated" clause in Section 1-101 alone must control fails for a number of reasons. The numerous clauses using the ERS name are hardly trivial. It is true that "Retirement System for Employees" is used three times in the translated Act, as codified. Id. §§ 761, 763(1), 779. [22] But "Employees Retirement System" is used far more often: by our count, more than thirty-five times in the Act as codified. Perhaps most importantly, "Employees Retirement System" is used in the primary definition of "[s]ystem." Id. § 763(36) ("System [s]hall mean the Employees Retirement System of the Government of the Commonwealth of Puerto Rico."). Other uses of the ERS name include in the heading of Section 1-101, id. § 761, as well as the headings of many other sections, see id. §§ 761a, 762, 763, 764, 765, 765a, 766, 766a, 766b, 766c, 766d, 768, 768a, 769, 769a, 770, 770a, 771, 772, 773, 774, 775, 776, 777, 778, 779, 779a, 779b, 779c, 781a, 782, 783, 784, 785, 786, 786a, 786b, 787, 788.

The System and the Committee have offered no explanation as to why, when both terms are used, the ERS name should be disregarded. It is difficult to discern why "Retirement System for Employees" is used instead of "Employees Retirement System" in the particular places where the RSE name is used. Nothing about the context suggests that one or the other should be used, and the underlying Spanish is the same.

We think a reasonable creditor would be familiar with the Commonwealth law that, in a case of a discrepancy between the English and Spanish, when the legislation originated in Spanish "the Spanish text shall be preferred to the English." P.R. Laws Ann. tit. 31, § 13; see Republic Sec. Corp. v. P.R. Aqueduct & Sewer Auth., 674 F.2d 952, 956 (1st Cir. 1982) ("[I]n cases of discrepancy 'the Spanish text shall be preferred.' "). Further, we see no evidence that the legislature of the Commonwealth intended to change the English name of the System to the RSE name and abandon the ERS name. We would expect to see a clear statement expressing a desire to change the translation, and there is no such statement. This expectation is only reinforced by Section 13, described above.

***14** The legislature provided a Statement of Motives to the 2013 amendment, which identified, for example, the fiscal crisis in Puerto Rico, the causes of the crisis, and the need to act promptly. Law No. 3 of April 4, 2013, 2013 P.R. Laws 39-64. And the legislature then explained "[e]ach one of the amendments," id. at 58, such as the "[i]ncrease in the employee contribution [rate]," id. at 59. There is no explanation in this section that the 2013 amendment was meant to change the name of the System. Earlier name changes, including in 2004, demonstrate generally that the legislature understands how to change the System's name when it wants to do so.

It is also significant that the RSE name referenced in the "to be designated" clause differs from prior longstanding official uses. From 1951 through 2012, translated versions of the Enabling Act used only "Employees Retirement System" in the first section. See, e.g., Law No. 447 of May 15, 1951, 1951 P.R. Laws 1298; P.R. Laws Ann. tit. 3, § 761 (1988); id. (2006), id. (2011). It is only the translation of

the 2013 amendment which breaks this consistent pattern. Of course, a long-standing name of an organization or agency that is named by statute can be changed by statute. Here, though, the legislature did change the System's name several times, including changing the name of the System in 2004 by removing "and its Instrumentalities" ("y sus Instrumentalidades") from the end of the System's name and by replacing "Government of Puerto Rico" with "Government of the Commonwealth of Puerto Rico" ("Gobierno del Estado Libre Asociado de Puerto Rico"). Law No. 296 of September 15, 2004, § 1-101; P.R. Laws Ann. tit. 3, § 761 (2006). But, with each of these changes, the "Employees Retirement System" part of the name remained the same. Our conclusion that there was no legislative intent to change the System's name is also bolstered by post-2014 legislative action. Years after the 2014 translation of the amended Enabling Act, the official translation of the Puerto Rico Financial Emergency and Fiscal Responsibility Act of 2017 referred to the System in part as "the Employees Retirement System." P.R. Laws Ann. tit. 3, § 9433(r).

Further, the ERS name is the name consistently used by the System itself, including in court filings, before and after the translation of the amended Act in 2014. There are many examples of this; we list only a few. In its complaint in this case, the System referred to itself as "the Employees Retirement System of the Government of the Commonwealth of Puerto Rico" or "ERS." The System referred to itself in the same way in its Answer to Defendant's Counterclaims. The System did not mention "Retirement System for Employees" or "RSE" in either document.

Independently, in its Title III Petition form, dated May 21, 2017, the ERS name was used under "Debtor's name." In the box on the Title III form asking for "[a]ll other names Debtor used in the last five years [-] Include any assumed names, trade names, and doing business as names," only a Spanish name was listed, "Adminstracion de los Sistemas de Retiro de los Empleados del Gobierna y la Judicatura," with no mention of "Retirement System for Employees." Further, the System made no statement that "Employees Retirement System" was being used as a trade name. Again, these are only a few of the many times that the System held itself out as the "Employees Retirement System" around the time of and after the translation of the amended Enabling Act was in effect. The district court determined, and the System now argues, that the System used the ERS name simply as a trade name after 2014. See In re: Fin. Oversight & Mgmt. Bd. for P.R., 590 B.R. at 592. We disagree.

***15** Finally, there is no doubt that the ERS name was the official and only name of the System for over sixty years. So, any putative creditors would have had to search under that name to find prior liens even if the System's name did change in 2014. See P.R. Laws Ann. tit. 19, § 2327(c) (providing that a secured party owning a lien on the debtor's property acquired prior to a name change is not required to file a new financing statement). This observation adds further support to the central proposition that any putative creditor who read the 2014 translation of the Enabling Act would conclude that, given the inconsistent use of both the ERS and RSE names, it should at the very least search under the long-standing ERS name.

All of these reasons lead us to conclude that "Employees Retirement System of the Government of the Commonwealth of Puerto Rico" remained a valid name for UCC purposes when the Financing Statement Amendments were filed.[23] In our view, a searcher, whether another creditor or merely an interested party, would conclude that a search under the ERS name was required. Similarly, a reasonable filer would have concluded that the ERS name was a correct name for the debtor for UCC purposes.

Because the Financing Statement Amendments used "Employees Retirement System of the Government of the Commonwealth of Puerto Rico," they contained an appropriate name of the debtor under the Commonwealth's Article 9. See P.R. Laws Ann. tit. 19, §§ 2322(a), 2323(a)(1), 2404(3)(B). Taken together with the 2008 Financing Statements, the Financing Statement Amendments met the requirements for perfection as of December 17, 2015. See id. § 2322(a).

D. Avoidance under PROMESA

Because we determine that the Bondholders satisfied Article 9's perfection requirements before the passage of PROMESA on June 30, 2016, we do not consider whether PROMESA would allow retroactive avoidance of unperfected liens.[24] The debtors do not argue that the strong-arm provision of the Bankruptcy Code, incorporated by reference in PROMESA, would allow

them to avoid the Bondholders' interest if the interest is perfected.

And as a "basic tenet of the law of secured transactions," a "perfected security interest prevails over a subsequent lien creditor." Ledford v. Easy Living Furniture, 52 B.R. 706, 710 (Bankr. S.D. Ohio 1985); accord Gen. Elec. Credit Corp. v. Nardulli & Sons, Inc., 836 F.2d 184, 189 (3d Cir. 1988) (holding that because the parties filed correctly and perfected their security interest, "their rights as lienholders are superior to those of the trustee as a hypothetical lienholder under 11 U.S.C. § 544"). Commonwealth law recognizes this rule of priority by implication, in stating that a judicial creditor's lien is superior to a prior unperfected security interest. See P.R. Laws Ann. tit. 19, § 2267(a)(2)(A). "Where a creditor has an unperfected lien on a debtor's property, the Bankruptcy Code empowers a trustee to avoid and preserve the lien for the benefit of the estate." DeGiacomo v. Traverse (In re Traverse), 753 F.3d 19, 26 (1st Cir. 2014) (emphasis added).

E. The Bondholders' Counterclaims

***16** The Bondholders also appeal the dismissal of their second and third counterclaims, both requests for declaratory judgment. Counterclaim Two sought a declaration stating that the "Bondholders hold valid, enforceable, attached, perfected, first priority liens on and security interest in the Pledged Property whether ERS became entitled to collect such property before or after the commencement of ERS's Title III case." Counterclaim Three sought a declaration stating that "because the employer contributions constitute 'special revenues,' [Bondholders'] security interests in and liens on employer contributions received by the [System] after the Petition Date remain enforceable pursuant to 11 U.S.C. § 928(a)." The Bondholders argue that the district court did not adequately address arguments for these counterclaims.

As to Counterclaim Two, the Bondholders acknowledged in the district court that the "[11 U.S.C.] section 552 issues need not be reached in light of the Summary Judgment Decision," and did not provide "any reason that the remaining aspects of Count Two should be resolved differently from the Claims resolved by the Summary Judgment Decision." As to Counterclaim Three, the Bondholders stipulated that "in light of the Summary Judgment decision [the Bondholders] are unable to identify any need for the [district court] to reach the alternative arguments."

Because we find the 2008 Financing Statements effective as amended, we remand to the district court for further consideration of the dismissals of these counterclaims in light of this opinion.

F. Violation of the January 2017 Stipulation

Finally, the Bondholders argue that ERS violated the January 2017 Stipulation between the parties, and the district court erred in determining that no violation occurred (or that it was beyond the scope of the proceeding). Specifically, they assert that the System violated that Stipulation because it requires that, "[t]o the extent that ERS receives any Commonwealth central government Employers' contributions, unless otherwise agreed in writing by the undersigned parties, such contributions shall be retained in the Segregated Account pending further order of the Court." The System points out that a Joint Stipulation between the parties in this case limited claims or counterclaims on employer contributions only to those received during May 2017.

Even assuming the Bondholders have not waived this argument, [25] it fails. The Joint Stipulation shows that the parties agreed that the scope of the adversary proceedings at the district court would include "ERS's rights with respect to employer contributions received during the month of May 2017," and beyond some other stipulated claims and counterclaims, "no other claims may be made by either side" (emphasis added). So only the contributions during the month of May 2017 are properly at issue here. But as the district court correctly noted, In re: Fin. Oversight & Mgmt. Bd. for P.R., 590 B.R. at 599, the Bondholders conceded in their Answer and Counterclaims below that "ERS was obligated to place Employers' Contributions into the Segregated Account only for the duration of the [PROMESA] Section 405 Stay," and the Section 405 stay expired as of May 1, 2017. The Bondholders have not explained how their argument concerning the alleged violation of the January 2017 Stipulation survives these admissions, taking into account the stipulated scope of the adversary proceedings. The district court correctly dismissed the Bondholders' claim regarding an alleged violation of the January 2017 Stipulation.

III.

***17** We affirm the district court's holding that the 2008 Financing Statements did not perfect the Bondholders' security interest in the "Pledged Property." We determine that the Bondholders met the requirements for perfection beginning on December 17, 2015, and so reverse the district court. PROMESA's incorporation of the Bankruptcy code does not allow for the avoidance of perfected liens, and so we vacate the district court's holding that the Bondholders' security interest can be avoided under PROMESA. Concerning the district court's dismissal of the Bondholders' second and third counterclaims with prejudice, we vacate and remand to the district court for further consideration in light of this opinion. We affirm the district court's dismissal of the Bondholders' claim regarding the January 2017 Stipulation. No costs are awarded.

All Citations

--- F.3d ----, 2019 WL 364029

Footnotes

* Of the Southern District of New York, sitting by designation.

1 We use this name here rather than "Retirement System for Employees of the Government of the Commonwealth of Puerto Rico," because the System, through the Financial Oversight and Management Board for Puerto Rico, filed its complaint in the district court under this name and refers to itself by this name in its brief to this court. In this opinion, the "ERS name" refers to the term beginning with "Employees Retirement System"; the "RSE name" refers to the term beginning with "Retirement System for Employees."

2 Although we do not reach this issue, we acknowledge with appreciation the assistance provided by the United States Department of Justice in submitting a brief as amicus curiae in support of the appellees.

3 The Resolution defined "Pledged Property" as:

> 1. All Revenues.
> 2. All right, title and interest of the System in and to Revenues, and all rights to receive the same.
> 3. The Funds, Accounts, and Subaccounts held by the Fiscal Agent, and moneys and securities and, in the case of the Debt Service Reserve Account, Reserve Account Cash Equivalents, from time to time held by the Fiscal Agent under the terms of this Resolution, subject to the application thereof as provided in this Resolution and to the provisions of Sections 1301 and 1303.
> 4. Any and all other rights and personal property of every kind and nature from time to time hereafter pledged and assigned by the System to the Fiscal Agent as and for additional security for the Bonds and Parity Obligations.
> 5. Any and all cash and non-cash proceeds, products, offspring, rents and profits from any of the Pledged Property mentioned described in paragraphs (1) through (4) above, including, without limitation, those from the sale, exchange, transfer, collection, loss, damage, disposition, substitution or replacement of any of the foregoing.

The Resolution's definition of "Revenues" included, among other things, "All Employers' Contributions."

4 The listed dates -- June 24 and July 2 -- are the dates stamped on the documents by the filing officer. The same is true for the listed dates for the Financing Statement Amendments.

5 The issue of the proper name of the System did not arise until February 28, 2014, when a translation of the 2013 amended Enabling Act was published.

6 Similar or lengthier gaps between the passage of laws and the promulgation of their official translations have occurred in the Commonwealth. For example, the official English translation of the 2004 amendment to the Enabling Act (passed on September 15, 2004), Law No. 296 of September 15, 2004, was certified and published on March 13, 2007.

7 Section 544(a) provides:

> The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by —
>
> (1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;
>
> (2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

11 U.S.C. § 544(a).

8 In other litigation before the commencement of the System's Title III case, the System had stated that at least some of the Bondholders had "valid and enforceable liens in over hundreds of millions of dollars of ERS revenue." Respondent Employees Retirement System of the Government of Puerto Rico's Brief in Opposition to Motion for Relief from the PROMESA Automatic Stay at 10, Altair Global Credit Opportunities Fund (A), LLC. v. Garcia Padílla, Case No. 3:16-cv-02696-FAB (D.P.R. Oct. 26, 2016). The district court noted this acknowledgment. In re: Fin. Oversight & Mgmt. Bd. for P.R., 590 B.R. at 587.

9 The Bondholders do not cite controlling authority on this issue. In Chase Bank of Fla., N.A. v. Muscarella, 582 So.2d 1196 (Fla. Dist. Ct. App. 1991), part of the collateral -- the "Partnership Interest" -- was listed in the financing statement itself, see id. at 1197, and so we agree that the "[Muscarella] opinion does not stand for the proposition that it is sufficient for a financing statement to merely refer to the underlying security agreement and thereby incorporate by reference that document's collateral description." First Midwest Bank v. Reinbold (In re: I80 Equip., LLC), 591 B.R. 353, 361 (Bankr. C.D. Ill. 2018). In Int'l Home Prod., Inc. v. First Bank of P.R., Inc., 495 B.R. 152 (D.P.R. 2013), the referenced document was attached to the financing statement rather than filed or accessible only elsewhere. Id. at 160 n.8.

And the citation to John Deere is inapposite here, because the reference in that case to a "starting point for investigation" does not refer to a description of collateral. 34 A.D.2d at 88, 310 N.Y.S.2d 945.

10 "UCC Official Comments do not have the force of law, but are nonetheless the most useful of several aids to interpretation and construction of the [UCC]." JOM, Inc. v. Adell Plastics, Inc., 193 F.3d 47, 57 n.6 (1st Cir. 1999) (internal quotation marks omitted).

11 Several of the cases cited by the Bondholders consider security agreements rather than financing statements. E.g. Nolden v. Plant Reclamation (In the matter of Amex-Protein Dev. Corp.), 504 F.2d 1056 (9th Cir. 1974); Greenville Riverboat, LLC v. Less, Getz & Lipman, P.L.L.C., 131 F.Supp.2d 842 (S.D. Miss. 2000). As noted, security agreements are private contracts that do not have the same public notice purpose as financing statements. See In re Softalk Publ'g Co., 856 F.2d 1328, 1330 (9th Cir. 1988).

12 Where a referenced document is not in the UCC records and its location is not listed in the financing statement itself (nor how to find it), an interested party must do additional searching at its own expense to determine the collateral at issue. This remains true even where the extrinsic document is publicly available elsewhere: The interested party still has to search beyond where the initial financing statement has been filed, and do so without any guidance. It may not have been difficult for interested parties to find the Resolution here, but no party disputes that additional searching would have been necessary.

Interested parties doing such a search could well have justifiable concerns about the extrinsic referenced document. How, for example, would an interested party know whether a description of collateral in the extrinsic document is the latest operative version (rather than a superseded version), whether that document is complete, or whether the document found on another website or at another location is authentic rather than doctored in some way? Forcing interested parties to undertake additional work and expense merely to find a basic collateral description cuts against the goal of expansion of commercial practices.

13 In re Cushman Bakery did not determine that further inquiry by interested parties regarding the specific encumbered collateral was required under Article 9, but instead stated only that "further inquiry from the parties concerned [would] be necessary to disclose the complete state of affairs" around a transaction. 526 F.2d at 28-29 (emphasis added).

14 At oral argument, counsel for the System suggested that the P.R. Department of State's Circular applied only to perfected interests. This is incorrect. The Circular refers to "initial financing statements" in bold text on both pages and does not limit its determination regarding retroactive effect to previously perfected interests.

15 As a general matter, the Supreme Court of the Commonwealth of Puerto Rico has suggested, considering this law, that it is "highly desirable that ... [a] new rule will have prospective effect; especially, when contractual or property rights are at stake." Almodóvar v. Róman, 125 P.R. Offic. Trans. 218 (P.R. 1990).

16 The 2008 Financing Statements also properly list the Secured Party as "The Bank of New York, as fiscal agent[.]"

17 The full definition of "Pledged Property" is the same as in the Resolution, and is reproduced in note 3, supra.

18 Article 9 also provides a safe harbor provision for minor errors or omissions: "A financing statement substantially satisfying the requirements of this subchapter is effective, even if it has minor errors or omissions, unless the errors or omissions make the financing statement seriously misleading." P.R. Laws Ann. tit. 19, § 2326(a). For a name,

> if a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor in accordance with § 2323 (a) of this title, the name provided does not make the financing statement seriously misleading.

Id. § 2326(c).

19 The System's argument by analogy to the UCC's provision, P.R. Laws Ann. tit. 19, § 2323(a)(4), regarding an individual's name on a driver's license, is unpersuasive. The System argues that since an incorrect name on a driver's license must be used as the party's name in a sufficient UCC filing, if the filing is made in the same state as the driver's license was issued, the RSE name must be used here (whether or not it is a correct name). This argument by analogy is necessarily premised on the view that the 2013 amended Act states only the RSE name, whether or not it is a translation error. If, as we conclude, the amended Act states the ERS name as a name for the System, a searcher can still rely only on official records and there is no issue about a searcher having to use an "incorrect" name.

More generally, the requirement for an individual with a driver's license issued in the state is not relevant here, where we consider a registered organization that is created and designated by statute.

20 The Spanish language at issue did not change in the 2013 amendment to the Enabling Act. The language translated as "to be designated as the 'Retirement System for Employees,' " is "que se denominará 'Sistema de Retiro de Los Empleados.' " Compare Law No. 3 of April 4, 2013, 2013 P.R. Laws 39 with id. (Spanish). This is the same Spanish language used after the last amendment to the Enabling Act in 2004. P.R. Leyes Ann. tit. 3, § 761 (2005). And indeed, the portion of the Spanish corresponding to the first part of the name of the System -- "Sistema de Retiro de Los Empleados" -- was the same in the original Enabling Act of 1951, and was translated there as "Employees Retirement System." Compare Law No. 447 of May 15, 1951, 1951 P.R. Laws 1298 with id. at 1299.

21 We do not need to decide whether a translation error occurred in this instance. We do note that in the relevant portion of the Spanish version of the Act, the Spanish preposition most commonly translated as "for" -- para -- is not used. See University of Cambridge, Spanish-English Dictionary, http://dictionary.cambridge.org/dictionary/spanish-english,"para."

22 It is not clear that the use in Section 779 refers to the same System, though we assume it does. This provision in English describes the "Retirement System of the Employees of the Government and its Instrumentalities," P.R. Laws Ann. tit 3, § 779, rather than "Retirement System for Employees of the Government of the Commonwealth of Puerto Rico," id. § 761.

23 Even were we to accept that "[t]he majority of cases decided under ... Article 9 are unforgiving of even minimal errors [for the name of the debtor]," In re John's Bean Farm of Homestead, Inc., 378 B.R. 385, 391 (Bankr. S.D. Fla. 2007), a filing under the ERS name is not such an error. The situation here is clearly unlike, for example, a filer misspelling the name of a tractor seller as "Roger" rather than "Rodger." See Pankratz Implement Co. v. Citizens Nat. Bank, 281 Kan. 209, 130 P.3d 57, 59 (2006).

24 Similarly, we need not consider the System's argument that the Bondholders' security interest was always inferior to subsequent perfected security interests and judicial liens under the UCC, see P.R. Laws Ann. tit. 19, §§ 2219(a)(1), 2212(52), 2267(a)(2)(A), because this argument is necessarily premised on the Bondholders having only an unperfected security interest. The System does not argue that the UCC would grant priority over a previously perfected lien, and the statutory text is clear on this issue. Id. § 2267(a)(2)(A).

25 Neither opening brief from the Bondholders makes a full argument concerning the alleged violation of the January 2017 Stipulation. See United States v. Zannino, 895 F.2d 1, 17 (1st Cir. 1990) ("It is not enough merely to mention a possible argument in the most skeletal way, leaving the court to do counsel's work, create the ossature for the argument, and put flesh on its bones.").

End of Document

913 F.3d 268
United States Court of Appeals, Second Circuit.

The PACA TRUST CREDITORS OF LENNY PERRY'S PRODUCE, INC., Plaintiffs-Appellees-Cross-Appellants,

v.

GENECCO PRODUCE INC., David Genecco, Defendants-Appellants-Cross-Appellees. *

Docket Nos. 17-1949-cv, 17-2051-cv
|
August Term, 2018
|
Submitted: September 5, 2018
|
Decided: January 9, 2019

Synopsis

Background: Unpaid produce supplier brought adversary proceeding under Perishable Agricultural Commodities Act (PACA) alleging that creditor of debtor merchant of perishable agricultural commodities wrongfully failed to pay debtor for produce held in trust for supplier. The United States Bankruptcy Court for the Western District of New York, Michael J. Kaplan, J., 2015 WL 9581383, issued recommendation for supplier to be granted summary judgment, but that creditor receive pro rata share of assets of trust established under PACA. The United States District Court for the Western District of New York, William M. Skretny, J., 2017 WL 2462035, adopted the report and recommendation and granted judgment accordingly. Parties appealed.

Holdings: The Court of Appeals, Sack, Circuit Judge, held that:

creditor was not entitled to statutory offset of its debts to debtor against debtor's debts to it under New York or bankruptcy law;

debtor's accounts receivable constituted PACA trust assets not subject to any offset claim associated with that transaction;

creditor did not carry its burden of demonstrating that debtor's accounts receivable did not constitute PACA trust assets; and

creditor could be allowed to recover pro rata share of PACA trust from account receivables.

Affirmed.

***270** Appeal from the United States District Court for the Western District of New York (William M. Skretny, *Judge*).

Attorneys and Law Firms

David L. Rasmussen, Mallory Kass Smith, Davidson Fink LLP, Rochester, New York, for Defendants-Appellants-Cross-Appellees.

Christopher M. Corrigan, Martyn & Associates, Cleveland, Ohio, for Plaintiffs-Appellees-Cross-Appellants.

Before: Sack, Raggi, and Chin, Circuit Judges.

Opinion

Sack, Circuit Judge:

The plaintiffs and the defendants are creditors of debtor Lenny Perry's Produce, Inc. ("LPP"). Between 2005 and 2008, defendant Genecco Produce, Inc., ("GPI") and debtor LPP regularly sold produce to one another. Because the goods were perishable agricultural commodities, these transactions were governed by the federal Perishable Agricultural Commodities Act, 7 U.S.C. § 499 ("PACA").

Instead of paying each other after each transaction, GPI and LPP accumulated mutual debts intended to offset one another. By the end of 2008, those debts totaled $204,774.88, owed by GPI to LPP, and $263,061.92, owed by LPP to GPI — a net balance of $58,287.04 in GPI's favor.

On January 27, 2009, LPP filed for bankruptcy protection under Chapter 7 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Western District of New York. The plaintiffs, also unpaid sellers of perishable agricultural commodities to LPP, brought

an adversary proceeding against the defendants in the bankruptcy court. They alleged that the $204,774.88 owed by GPI to LPP constituted assets of a trust that arose for their benefit under the terms of PACA ("PACA Trust"). In response, the defendants asserted that federal bankruptcy law, 11 U.S.C. § 553(a), and New York State law, N.Y. Debt. & Cred. L. § 151, entitled them to a complete offset of any amount otherwise due to the PACA Trust ***271** by amounts that had been due to the defendants from LPP.

On June 7, 2017, the United States District Court for the Western District of New York (William M. Skretny, *Judge*) entered a judgment adopting the bankruptcy judge's report and recommendation (Michael J. Kaplan, *Bankruptcy Judge*) recommending that summary judgment be granted to the plaintiffs. The district court concluded that the defendants were not entitled to a full offset of their mutual unpaid debts, but only to a pro rata share of the PACA Trust along with other unpaid LPP produce suppliers.

The defendants argue that the district court erred because New York State law and federal bankruptcy law entitle them to a complete offset of any amounts they owed LPP or the PACA Trust; in the alternative, they claim that questions of fact regarding the transfer of accounts receivable into the PACA Trust render the district court's grant of summary judgment improper.

We disagree. Because PACA assets are held in trust for the benefit of unpaid produce suppliers generally and never become part of a bankruptcy estate, and because such PACA creditors enjoy priority over non-PACA creditors, the defendants' offset defense under section 553 of the U.S. Bankruptcy Code and New York State law is unavailing. The district court therefore correctly found that the plaintiffs' claims against the defendants are not subject to the statutory offset sought by the defendants.

Meanwhile, the plaintiffs assert that the district court erred in permitting the defendants to recover even a pro rata share of the PACA Trust. The plaintiffs do not dispute that the defendants, like the plaintiffs, are PACA creditors. Rather, they contend that the defendants are barred from recovery because they did not file a proof of claim pursuant to the district court's claims procedure order ("Claims Procedure Order"), which established deadlines for the plaintiffs' counsel to issue written notice to potential PACA claimants and for prospective claimants to file proofs of claim.

We conclude otherwise. The defendants preserved their PACA claims by providing statutorily required notice to the debtor in each invoice at issue and filed a proof of claim with the bankruptcy court before the district court had issued the PACA Claims Procedure Order. Based at least, in part, on ambiguities in that Order, they reasonably, although mistakenly, thought that they could vindicate their rights as PACA creditors using a bankruptcy offset and elected not to file a PACA proof of claim. Under these circumstances, as the district court correctly concluded, PACA's statutory purpose is best realized if the defendants are permitted to collect pro rata shares of the PACA assets. The district court did not err in allowing the defendants to recover their pro rata share.

The judgment of the district court is therefore affirmed.

BACKGROUND

General Factual Background

At all relevant times, GPI, and LPP before it filed for bankruptcy, were merchants of perishable agricultural commodities operating out of the Niagara Frontier Food Terminal in Buffalo, New York. Between September 2005 and October 2008, LPP and GPI regularly sold produce to one another for resale to their respective customers. In connection with each transaction, the seller—LPP or GPI—issued an invoice to the other with a notice of intent ***272** to preserve its PACA rights. [1]

Usually, neither GPI nor LPP would pay the other for the produce they sold to one another. Instead, they maintained open, off-setting accounts. Although GPI and LPP tried "to make sure ... GPI was not sending Lenny Perry's more produce than Lenny Perry's was sending GPI," their efforts were not entirely successful. Report and Recommendation at 4, *PACA Trust Creditors of Lenny Perry's Produce, Inc. v. Genecco Produce, Inc.*, No. 09-1269-MJK (W.D.N.Y. Feb. 12, 2014), ECF No. 126. By January 2009, LPP owed GPI $263,061.92, and GPI owed LPP $204,774.88, resulting in a net balance of $58,287.04 in GPI's favor.

The plaintiffs [2] are also merchants dealing in perishable agricultural commodities. Like GPI, they sold fresh

produce to LPP. Those sales for which the plaintiffs were never paid are governed by PACA. When LPP filed for bankruptcy, it owed the plaintiffs an estimated $292,417.39.

Procedural History

On January 27, 2009, LPP and its principal, Leonard R. Perry, filed "Voluntary Petitions" for protection under Chapter 7 of the Bankruptcy Code in the United States Bankruptcy Court for the Western District of New York. On February 17, 2009, GPI filed a proof of claim for $263,061.92. On March 9, 2009, the plaintiffs brought an adversary proceeding against LPP and Perry in that court alleging PACA violations and a breach of fiduciary duty owed to the PACA beneficiaries.

The plaintiffs filed a motion to establish a PACA claims procedure, which the bankruptcy court granted on August 7, 2009. Under the Claims Procedure Order, LPP was required, on or before August 12, 2009, to provide the plaintiffs' counsel with names and addresses of all potential PACA claimants not already listed in the bankruptcy petition. Also by order of the court, the plaintiffs' counsel had until August 17, 2009, to issue written notice of the Claims Procedure Order to potential PACA claimants, and prospective PACA claimants had until August 31, 2009, to file complaints in intervention and PACA proofs of claim. Although the plaintiffs timely served GPI with notice of the Claims Procedure Order, GPI elected not to file a PACA claim but to pursue its offset claim instead.

On November 4, 2009, the PACA Trust beneficiaries instituted an adversary proceeding against the defendants alleging that between September 2005 and October 2008, LPP delivered to GPI fresh produce worth a total of $204,774.88, for which they were not compensated. The beneficiaries further alleged that LPP's accounts receivable from those sales constituted PACA Trust assets. On December 30, 2009, the defendants filed an answer asserting that they were "entitled to a setoff in the amount of $263,061.92," owed to them by LPP, "which is in excess of the $204,774.88 ***273** claimed to be due and owing by [the plaintiffs]." App'x 94.

Motion to Strike

On January 15, 2010, the plaintiffs filed a motion to strike the defendants' statutory-offset defense. They argued that the defendants' offset rights, if any, could only be asserted against LPP, not the PACA Trust or its beneficiaries. On August 14, 2012, the bankruptcy court recommended that the district court deny the plaintiffs' motion because it would be "unfair and inequitable" to strike the offset defense unless the defendants are "permitted a late 'opt-in' to share as [ ] beneficiar[ies] of the Trust."[3] *PACA Trust Creditors of Lenny Perry's Produce, Inc. v. Genecco Produce, Inc. (In re Lenny Perry's Produce)*, Bankr. No. 09-10297 K, 2012 WL 7767580, at *4, 2012 Bankr. LEXIS 5440 (Bankr. W.D.N.Y. Aug. 14, 2012). On November 12, 2012, the district court adopted the bankruptcy court's recommendation. *John B. Ordille, Inc. v. Lenny Perry's Produce, Inc.*, No. 12-MC-54S, 2012 WL 5499652, 2012 U.S. Dist. LEXIS 161648 (W.D.N.Y. Nov. 12, 2012).

Motion for Summary Judgment

On May 3, 2013, the plaintiffs moved for summary judgment, renewing their argument that GPI could only bring an offset claim against LPP, not against the plaintiffs. On February 12, 2014, the bankruptcy court recommended that the district court grant the plaintiffs' motion. Report and Recommendation, *PACA Trust Creditors of Lenny Perry's Produce, Inc. v. Genecco Produce, Inc.*, No. 09-1269-MJK (W.D.N.Y. Feb. 12, 2014), ECF No. 126. It rejected the defendants' argument that a long-term bartering arrangement had extinguished GPI's debts to LPP. The bankruptcy court noted that GPI had failed to produce any tax documents or other evidence to substantiate its claim of a bartering arrangement with LPP. To the contrary, it concluded, "the parties were simply selling commodities to each other ..., maintaining open, off-setting accounts that remained so (meaning never materially reconciled by off-set) right up until the [d]ebtor went out of business." *Id.* For that reason, it recommended that the district court enter judgment in favor of the plaintiffs in the amount that GPI owed to LPP, less GPI's pro rata share of the PACA Trust.

On September 4, 2014, the district court remanded the matter to the bankruptcy court for further proceedings. *PACA Trust Creditors of Lenny Perry's, Inc. v. Genecco Produce, Inc.*, No. 14-MC-036S, 2014 WL 4385436, at *1, 2014 U.S. Dist. LEXIS 123965 (W.D.N.Y. Sept. 4, 2014). It explained that because "bartering and setoff are different concepts," the absence of a bartering relationship does not necessarily defeat an offset defense. *Id.* at *3-4; 2014 U.S. Dist. LEXIS 123965, at *7. The district court

directed the bankruptcy court, on remand, to consider whether (i) GPI's debt to LPP and LPP's debt to GPI constitute "mutual debt[s]" for purposes of section 553 of the Bankruptcy Code, and (ii) whether any funds due from GPI to LPP are PACA Trust assets not subject to the defendants' offset claim. *Id.* at *2-3; 2014 U.S. Dist. LEXIS 123965, at *7, 9-10.

On February 23, 2015, the bankruptcy court issued a "Clarified Report and Recommendation," which explained in greater detail—but did not materially alter—its February 12, 2014 recommendation. ***274** *PACA Trust Creditors of Lenny Perry's Produce, Inc. v. Genecco Produce, Inc. (In re Lenny Perry's Produce, Inc.)*, No. 09-10297 K, 2015 Bankr. LEXIS 2713 (Bankr. W.D.N.Y. Feb. 23, 2015). On August 12, 2015, the district court again remanded the matter to the bankruptcy court, explaining that "clarification of the issues raised in the parties' submissions as well as this Court's prior order is warranted." *PACA Trust Creditors of Lenny Perry's Produce v. Genecco Produce, Inc.*, No. 15-MC-028S, 2015 WL 4761627, at *6, 2015 U.S. Dist. LEXIS 105908 (W.D.N.Y. Aug. 12, 2015).

The bankruptcy court issued what turned out to be its final report and recommendation on December 28, 2015. *PACA Trust Creditors of Lenny Perry's Produce, Inc. v. Genecco Produce, Inc. (In re Lenny Perry's Produce, Inc.)*, No. 09-10297 K, 2015 WL 9581383, 2015 Bankr. LEXIS 4371 (Bankr. W.D.N.Y. Dec. 28, 2015). The court concluded that "the Trust's rights are not now, and never were, subject to the limitations that [LPP] suffered as to [GPI], or the defenses that [GPI] had against [LPP]." *Id.* at *2; 2015 Bankr. LEXIS 4371, at *4-5. In the bankruptcy court's view, "every item of perishable commodities [LPP] ever handled was held by it in trust, as were any proceeds realized from those items," so that "everything that [LPP] received from [GPI] or was entitled to receive from [GPI] on account of perishable commodities delivered to [GPI] was subject to the statutory PACA Trust in favor of growers, cooperatives, etc.[,] which were owed money for those commodities." *Id.* at *2; 2015 Bankr. LEXIS 4371, at *5. The PACA Trust existed "from the moment that [LPP] bought or sold commodities subject to PACA." *Id.* at *2; 2015 Bankr. LEXIS 4371, at *5.

The bankruptcy court further decided that LPP and GPI's method of doing business by maintaining mutual debts "was not consistent with PACA," which requires timely payments "so that all providers of perishable agricultural commodities to [LPP] had a chance to receive cash payments from [GPI] for what they provided." *Id.* at *4; 2015 Bankr. LEXIS 4371, at *11-12. It concluded that "equity requires treatment that PACA would seem to require," *id.* at *4; 2015 Bankr. LEXIS 4371, at *12: a judgment against GPI equal to "the *difference* between what [GPI] owed [LPP] on the date of the Chapter 7 petition (and therefore owes to the PACA Trust) and the amount that [GPI] would receive as a PACA Trust beneficiary," *id.* at *6; 2015 Bankr. LEXIS 4371, at *19 (emphasis in original).

On June 7, 2017, the district court adopted the bankruptcy court's recommendation in full. *PACA Trust Creditors of Lenny Perry's Produce, Inc. v. Genecco Produce Inc.*, No. 16-MC-4S, 2017 WL 2462035, 2017 U.S. Dist. LEXIS 87488 (W.D.N.Y. June 7, 2017). The district court rejected the defendants' argument that they are entitled to a complete offset. It observed that offsets only apply to mutual debts, and the debts between GPI and LPP are "mutual only to the extent [d]efendants are co-beneficiaries to the PACA Trust. And, to the extent that they are co-beneficiaries, [p]laintiffs and [d]efendants owe one another a fiduciary duty to take no more than their [pro rata] share of trust assets." *Id.* at *2; 2017 U.S. Dist. LEXIS 87488, at *4. The district court also rejected the plaintiffs' argument that the defendants' failure to file a PACA claim precludes them from recovering a pro rata share of the PACA Trust. Instead, the district court decided that allowing the defendants limited recovery as PACA creditors "best furthers the policies of PACA." *Id.* at *1; 2017 U.S. Dist. LEXIS 87488, at *4. The district court concluded that although the defendants are not entitled to an offset under bankruptcy law, they may recover a pro rata share of the ***275** PACA Trust. *Id.* at *2; 2017 U.S. Dist. LEXIS 87488, at *4-5.

DISCUSSION

There are two issues raised on appeal: First, whether the district court erred in concluding that LPP's accounts receivable constitute PACA Trust assets and that the defendants are therefore not entitled to a statutory offset of their debts to LPP against LPP's debts to them; and second, whether the district court erred in allowing the defendants to recover a pro rata share of the PACA Trust. The defendants argue that the Bankruptcy Code,

11 U.S. Code § 553, which governs "Setoff," entitles them to a complete offset of any amount otherwise due to the PACA Trust. The plaintiffs respond that the defendants may not recover even a pro rata share of the PACA Trust because they elected not to participate in the PACA claims procedure in the bankruptcy court. For the reasons discussed below, we affirm the district court's judgment in its entirety.

I. Standard of Review

"We review a grant of summary judgment de novo, examining the evidence in the light most favorable to, and drawing all inferences in favor of, the non-movant." *Blackman v. N.Y. City Transit Auth.*, 491 F.3d 95, 98 (2d Cir. 2007) (per curiam) (quoting *Sheppard v. Beerman*, 317 F.3d 351, 354 (2d Cir. 2003)). Summary judgment is appropriate only if "the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). A genuine dispute exists if "the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Fireman's Fund Ins. Co. v. Great Am. Ins. Co. of N.Y.*, 822 F.3d 620, 631 n.12 (2d Cir. 2016) (internal quotation marks omitted). However, "a party may not rely on mere speculation or conjecture as to the true nature of the facts to overcome a motion for summary judgment." *Fletcher v. Atex, Inc.*, 68 F.3d 1451, 1456 (2d Cir. 1995) (internal quotation marks omitted). The party opposing summary judgment "must do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986).

When a district court interprets its own order, we apply an abuse-of-discretion standard. *Garcia v. Yonkers Sch. Dist.*, 561 F.3d 97, 103 (2d Cir. 2009); *see also United States v. Spallone*, 399 F.3d 415, 423 (2d Cir. 2005) ("When an issuing judge interprets his own orders, we accord substantial deference to the draftsman, and we will not reverse the judge's construction of an ambiguity in his own words except for abuse of discretion.").

II. Statutory Offset

The defendants advance two arguments challenging the district court's conclusion that they are not entitled to a complete offset of the debts covered by PACA from them to LLP against those from LLP to the defendants under New York State law and federal bankruptcy law. First, they argue that LPP's relevant accounts receivable were transferred to the PACA Trust, if at all, subject to the defendants' offset rights. Second, they argue that factual disputes exist as to whether LPP's accounts receivable constituted PACA Trust assets. We reject both arguments.

1. Availability of Offset Defense Against the Plaintiffs' PACA Claim

The defendants claim that "[n]o authority exists," Defendants' Br. 14, that would require the defendants to "pay [their] ***276** debts in full to the bankrupt[ ], while allowing the [defendants] to recover only a percentage of the debts owed to [them] by the bankrupt[, LPP]," *id.* at 13 (internal quotation marks omitted). Not so. The statutory language of PACA and section 553 of the U.S. Bankruptcy Code, as well as this Court's prior decisions, require precisely that.

The PACA trust provision, which Congress enacted in order "to make the sellers' interests in the commodities and sales proceeds superior to those of the buyers' creditors," *Am. Banana Co. v. Rep. Nat'l Bank of N.Y.*, 362 F.3d 33, 37 (2d Cir. 2004), states in relevant part:

> Perishable agricultural commodities received by a commission merchant, dealer, or broker in all transactions ... and any receivables or proceeds from the sale of such commodities or products, shall be held by such commission merchant, dealer, or broker in trust for the benefit of all unpaid suppliers or sellers of such commodities or agents involved in the transaction, until full payment of the sums owing in connection with such transactions has been received by such unpaid suppliers, sellers, or agents.

7 U.S.C. § 499e(c)(2). Under regulations adopted by the U.S. Department of Agriculture ("DOA"), PACA assets "are to be preserved as a nonsegregated 'floating' trust." 7 C.F.R. § 46.46(b). PACA and related DOA regulations provide produce sellers with "a self-help tool enabling

them to protect themselves against the abnormal risk of losses resulting from slow-pay and no-pay practices by buyers or receivers of fruits and vegetables." *Coosemans Specialties, Inc. v. Gargiulo*, 485 F.3d 701, 705 (2d Cir. 2007) (citations omitted).

We have explained that "[o]rdinary principles of trust law apply to the trusts created by [PACA] ... so that the Produce Debtor holds the legal title to the Produce and its derivatives or proceeds but the seller retains an equitable interest in the trust property pending payment[.]" *Tom Lange Co. v. Kornblum & Co. (In re Kornblum & Co.)*, 81 F.3d 280, 284 (2d Cir. 1996) (citations omitted). Because PACA creditors hold an equitable interest in the PACA trust pending payment, "the Bankruptcy Code excludes PACA trust assets from the bankruptcy estate." *Id.* (citing, *inter alia*, *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n.10, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983) (explaining that the Bankruptcy Code "plainly exclude[s from the bankruptcy estate] property of others held by the debtor in trust at the time of the filing of the [bankruptcy] petition")). Consequently, PACA "gives unpaid [produce] suppliers ... priority over secured lenders ... to PACA trust assets." *Albee Tomato, Inc. v. A.B. Shalom Produce Corp.*, 155 F.3d 612, 615 (2d Cir. 1998).

The defendants' reliance on bankruptcy law to defend against PACA claims is misplaced. To the extent the disputed assets represent PACA Trust assets, they are held outside the bankruptcy estate, and their disposition is, therefore, governed by trust law rather than bankruptcy law. *See Kornblum*, 81 F.3d at 284. To permit a bankruptcy offset against PACA Trust assets would be inconsistent with Congress's intent in amending PACA in 1984 to "broaden the protections afforded to produce suppliers" who had previously "receive[d] little protection in any suit for recovery of damages where a buyer ha[d] failed to make payment as required by the contract." *Id.* at 283 (citation omitted). Because PACA provides unpaid produce sellers with priority over other creditors and establishes that the disposition of PACA assets is governed by trust law, *see id.* at 284, we conclude that the district court did not err in deciding that the defendants are not entitled to the offset they ***277** seek under New York and federal-bankruptcy law. [4]

2. No Genuine Dispute of Material Fact

The defendants next argue that material factual disputes exist as to whether LPP's accounts receivable for the sale of produce to the defendants, totaling $204,774.88, constitute PACA Trust assets. The defendants suggest that because they sought an offset before the district court issued its Claims Procedure Order, LPP's receivables never became PACA Trust assets, or, if they did, they were transferred subject to the defendants' offset rights.

The defendants' argument misses the mark. We have explained that a PACA trust "is automatically established each time a broker or merchant purchases perishable commodities." *D.M Rothman & Co., Inc. v. Korea Commercial Bank of N.Y.*, 411 F.3d 90, 96 (2d Cir. 2005); *accord C&E Enters., Inc. v. Milton Poulos, Inc. (In re Milton Poulos, Inc.)*, 947 F.2d 1351, 1352 (9th Cir. 1991) ("The [PACA] trust automatically arises in favor of a produce seller upon delivery of produce[.]"); *Patterson Frozen Foods, Inc. v. Crown Foods Int'l, Inc.*, 307 F.3d 666, 669 (7th Cir. 2002) ("Th[e PACA] floating trust is automatically created when the dealer accepts the goods[.]"). Any factual dispute as to whether the defendants asserted their offset claim before the district court issued the Claims Procedure Order is immaterial: Even if the defendants' offset claim predates the Claims Procedure Order, the PACA Trust arose immediately upon the sale of produce from the plaintiffs to LPP—long before the defendants asserted their offset claim—such that the accounts receivable associated with those transactions would not be subject to that defense.

The defendants further argue that the plaintiffs have failed to establish that the accounts receivable were PACA Trust assets. This argument, too, fails. It is the defendants who bear the burden of demonstrating that disputed assets do *not* constitute PACA trust assets. *Kornblum*, 81 F.3d at 287. They have not met that burden. Nothing in the record suggests that LPP entered into a factoring agreement with GPI, that LPP and GPI engaged in a bartering relationship, or that LPP and GPI paid down their mutual debts. Instead, the record establishes that LPP and GPI's debts to each other remained outstanding when GPI filed for bankruptcy.

The defendants thus have failed to identify any genuine dispute of material fact as to whether LPP's accounts receivable constitute PACA Trust assets.

***278 III. Pro Rata Share**

Finally, we address the district court's decision to award the defendants a pro rata share of the PACA Trust, in light of the defendants' loss on their set-off claim and failure to file a proof of claim after the district court issued the Claims Procedure Order. The bankruptcy court recommended that the district court allow the defendants to recover a pro rata share, in part because the Claims Procedure Order did not specify which "receivables" were "trust assets"; it was therefore "not unreasonable for [GPI] to have relied upon its belief that ordinary setoff rights as to 'receivables' would apply." *In re Lenny Perry's Produce*, 2012 WL 7767580, at *4, 2012 Bankr. LEXIS 5440, at *14–15, *adopted*, *John B. Ordille, Inc. v. Lenny Perry's Produce, Inc.*, No. 12-MC-54S, 2012 WL 5499652, 2012 U.S. Dist. LEXIS 161648 (W.D.N.Y. Nov. 12, 2012).

The district court agreed: It noted that the "[d]efendants raised their defense of offset even before the PACA Claims Procedure was established," and concluded that they "had a good faith basis for pursuing their claims through a bankruptcy offset rather than through the PACA claims process." *PACA Trust Creditors of Lenny Perry's Produce, Inc.*, 2017 WL 2462035, at *1, 2017 U.S. Dist. LEXIS 87488, at *4.

The district court did not err in allowing the defendants to recover a pro rata share of the PACA Trust. It is undisputed that the defendants complied with all statutory requirements to preserve their PACA claims: In each invoice that GPI sent to LPP, it provided written notice of intent to preserve its PACA rights. It is also undisputed that the defendants filed a proof of claim in bankruptcy court before the Claims Procedure Order was issued, for an offset in the amount of $263,061.92. Having filed an offset claim, the defendants reasonably thought that their debt to LPP was not a "receivable" under the Claims Procedure Order and that they were not required to submit a PACA proof of claim. The bankruptcy court and district court properly concluded that, in light of ambiguities in the Claims Procedure Order and the novelty of the legal issues presented, the defendants had a good-faith basis to pursue their claims through a bankruptcy offset in lieu of a PACA claim.

Moreover, the statute states, in relevant part, that perishable goods and any receivables from their sale are held in trust "for the benefit of *all* unpaid suppliers or sellers of such commodities or agents involved in the transaction, until full payment of the sums owing in connection with such transactions has been received by such unpaid suppliers, sellers, or agents." 7 U.S.C. § 499e(c)(2) (emphasis added). The defendants are unpaid suppliers of produce. Denying them a pro rata share of the PACA Trust, even though they preserved their PACA claims and filed a proof of claim in bankruptcy court, would be, we think, inconsistent with the statutory text and the district court's interpretation of its own Claims Procedure Order. We therefore conclude that the district court did not err in permitting the defendants to recover a pro rata share of the PACA Trust.

CONCLUSION

We have considered the parties' other arguments on appeal and conclude that they are without merit. For the foregoing reasons, we AFFIRM the judgment of the district court.

All Citations

913 F.3d 268, 66 Bankr.Ct.Dec. 177

Footnotes

* The Clerk of the Court is directed to amend the official caption to conform to the listing of the parties above.

1 The invoices contained the following language, which the Act, at section 499e(c)(4), identifies as sufficient to provide notice of intent to preserve PACA benefits: "The perishable agricultural commodities listed on this invoice are sold subject to the statutory trust authorized by section 5(c) of the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. 499e(c)). The seller of these commodities retains a trust claim over these commodities, all inventories of food or other products derived from these commodities, and any receivables or proceeds from the sale of these commodities until full payment is received." *See* LPP Invoices, App'x 134-395.

2 The plaintiffs are Burch Equipment LLC, Jackson's Farming Co., Pismo Oceano Vegetable Exchange, Wings Landing Farm, Brooks Tropicals LLC, John B. Ordille Inc., and Weis-Buy Farms Inc.

3 Although the district court has jurisdiction over the adversary proceeding between the plaintiffs and the defendants, it entered a Special Order of Reference to the bankruptcy court. Pursuant to that Special Order, the bankruptcy court presided over each of the motions filed in this matter and issued reports and recommendations to the district court.

4 This conclusion is buttressed by the language in section 553 of the U.S. Bankruptcy Code, which makes offsets available only for "mutual" debts. 11 U.S.C. § 553(a). Mutuality exists where debts "are due to and from the same persons in the same capacity." *Westinghouse Credit Corp. v. D'Urso*, 278 F.3d 138, 149 (2d Cir. 2002) (citations omitted). The debts here are not mutual because the defendants and LPP appear in different capacities: The defendants assert their claim to $263,061.92 in their capacity as creditors in LPP's bankruptcy proceeding; LPP, by contrast, does not—and cannot—assert a claim for $204,774.88 in its capacity as a creditor, but instead pursues those funds solely on behalf of unpaid suppliers. *See* 7 U.S.C. § 499e(c)(2) ("Perishable agricultural commodities received by a ... merchant, ... and any receivables or proceeds from the sale of such commodities ..., shall be held ... in trust for the benefit of all unpaid suppliers ... until full payment of the sums owing ... has been received by such unpaid suppliers[.]"); *cf. D'Urso*, 278 F.3d at 149 ("[O]bligations lack mutuality where one party is a trust beneficiary asserting his or her rights against a trustee, and the other is a creditor exercising his or her contractual rights[.]").

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2019 WL 384060
Only the Westlaw citation is currently available.
This case was not selected for
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RULINGS BY SUMMARY ORDER DO NOT HAVE PRECEDENTIAL EFFECT. CITATION TO A SUMMARY ORDER FILED ON OR AFTER JANUARY 1, 2007, IS PERMITTED AND IS GOVERNED BY FEDERAL RULE OF APPELLATE PROCEDURE 32.1 AND THIS COURT'S LOCAL RULE 32.1.1. WHEN CITING A SUMMARY ORDER IN A DOCUMENT FILED WITH THIS COURT, A PARTY MUST CITE EITHER THE FEDERAL APPENDIX OR AN ELECTRONIC DATABASE (WITH THE NOTATION "SUMMARY ORDER"). A PARTY CITING A SUMMARY ORDER MUST SERVE A COPY OF IT ON ANY PARTY NOT REPRESENTED BY COUNSEL.
United States Court of Appeals, Second Circuit.

IN RE SEVEN OAKS PARTNERS, LP, Debtor.
Seven Oaks Partners, LP, James M. Nugent, Esq., Douglas S. Skalka, Esq., Debtors–Appellees,
v.
Cynthia Licata, Creditor–Appellant.

18-342
|
January 30, 2019.

Appeal from a judgment of the United States District Court for the District of Connecticut (Arterton, J.).

UPON DUE CONSIDERATION, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the judgment of the district court be **AFFIRMED.**

Attorneys and Law Firms

FOR APPELLANT: John F. Carberry, Cummings & Lockwood LLC, Stamford, CT.

FOR APPELLEE: James M. Nugent, Harlow, Adams & Friedman, P.C., Milford, CT.

PRESENT: AMALYA L. KEARSE DENNIS JACOBS, ROBERT D. SACK, Circuit Judges.

SUMMARY ORDER

***1** Cynthia Licata appeals from a judgment of the United States District Court for the District of Connecticut (Arterton, J.) affirming the decision of the bankruptcy court to deny her claim against Seven Oaks Partners as untimely. Licata possessed a $500,000 judgment against Seven Oaks Partners, LP at the time it filed for Chapter 11 bankruptcy in April 2012, but Seven Oaks failed to list her as a creditor. In November 2012, Seven Oaks added Licata as holding a "disputed" and "unliquidated" claim and the court set July 8, 2013 as the bar date by which she could file a proof of claim. Licata filed a proof of claim on September 5, 2014. Seven Oaks objected on the basis of untimeliness, the bankruptcy court (Manning, J.) sustained the objection, and the district court subsequently affirmed. The question on appeal is whether Licata's failure to timely file her claim is the result of excusable neglect. We assume the parties' familiarity with the underlying facts and procedural history.

Licata claims that the bankruptcy court abused its discretion in disallowing her proof of claim because Seven Oaks first omitted listing her claim, then improperly scheduled her claim as one that was disputed and unliquidated rather than as liquidated and reflected in a final judgment, and then failed to properly notify her of the proceeding. Because—at a minimum through service on her lawyer—Licata had notice of the bankruptcy proceedings before the bar date, we disagree.

"In an appeal from a district court's review of a bankruptcy court decision, we review the bankruptcy court decision independently, accepting its factual findings unless clearly erroneous but reviewing its conclusions of law de novo." In re Enron Corp., 419 F.3d 115, 124 (2d Cir. 2005) (quoting In re AroChem Corp, 176 F.3d 610, 620 (2d Cir. 1999)). "Bankruptcy court decisions to deny a request to file late are reviewed for abuse of discretion." Id.

In bankruptcy, a "bar date" fixes the time to file a proof of claim against the bankruptcy estate. See Fed. R. Bankr. P. 3002(c)(3). Bankruptcy Rule 9006(b)(1) "empowers a bankruptcy court to permit a late filing if the movant's failure to comply with an earlier deadline 'was the result of excusable neglect.' " Pioneer Inv. Servs. Co. v. Brunswick Associates L.P., 507 U.S. 380, 382, 113 S.Ct. 1489, 123 L.Ed.2d 74 (1993). "The burden of proving excusable

neglect lies with the late–claimant." In re Enron, 419 F.3d at 121.

Whether neglect is excusable is an equitable determination, " 'taking account of all relevant circumstances surrounding the party's omission,' including '[1] the danger of prejudice to the debtor, [2] the length of the delay and its potential impact on judicial proceedings, [3] the reason for the delay, including whether it was within the reasonable control of the movant, and [4] whether the movant acted in good faith.' " Id. at 122 (quoting Pioneer, 507 U.S. at 395, 113 S.Ct. 1489) (alterations in original). The "focus" of our inquiry is whether the movant was responsible for the delay. Id.

The bankruptcy court did not abuse its discretion in denying Licata's late filed claim because Licata was responsible for the delay. Critically, Licata had notice, through her lawyer, of Seven Oaks's bankruptcy and the allegedly erroneous scheduling of her claim as "disputed" and "unliquidated," in November 2012. The bankruptcy court found that Seven Oaks served notice on Licata at five different addresses, including that of her lawyer, Ridgely Brown. See Pioneer, 507 U.S. at 397, 113 S.Ct. 1489 ("[I]n determining whether respondents' failure to file their proofs of claim prior to the bar date was excusable, the proper focus is upon whether the neglect of respondents *and their counsel* was excusable.") (emphasis in original). At a hearing on November 13, 2012, where he was representing Licata in nonbankruptcy proceedings against Seven Oaks, Brown discussed Seven Oaks's bankruptcy, its impact on Licata's $500,000 judgment, and the scheduling of Licata's claim. Licata was therefore on notice in November 2012. And because she then failed to file her proof of claim until September 2014, Licata's neglect is inexcusable.

***2** Licata argues that because Seven Oaks mischaracterized her claim in bad faith, requiring compliance with the bar date will encourage future gamesmanship by debtors; after all, had Seven Oaks scheduled her claim as undisputed, Licata's filing would have been unnecessary.

But the improper scheduling of a claim by a Chapter 11 debtor does not excuse an untimely filing where the creditor had actual notice of the debtor's bankruptcy. See 4 Collier on Bankruptcy ¶ 523.09[4][a] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.) (citing Lompa v. Price (–In re Price–), 79 B.R. 888, 893 (9th Cir. BAP 1987)). If a creditor has notice or actual knowledge of the bankruptcy with sufficient time to timely file a proof of claim, the debt will be discharged even though not listed or scheduled, listed or scheduled improperly, or listed or scheduled tardily. Id. Regardless of the correctness of any allegations of bad faith, once Licata possessed actual knowledge of Seven Oaks's bankruptcy and scheduling of her claim, it was her responsibility to file a proof of claim and correct Seven Oaks's mistaken characterization of her claim as disputed and unliquidated before the established bar date.

Accordingly, Licata failed to demonstrate excusable neglect and the bankruptcy court was within its discretion to deny her late filed claim.

We have considered Licata's remaining arguments and find them to be without merit. For the foregoing reasons, we **AFFIRM** the judgment of the district court.

All Citations

--- Fed.Appx. ----, 2019 WL 384060 (Mem)

913 F.3d 533
United States Court of Appeals, Fifth Circuit.

IN RE: ULTRA PETROLEUM CORPORATION; Keystone Gas Gathering, L.L.C.; Ultra Resources, Incorporated; Ultra Wyoming, Incorporated; Ultra Wyoming LGS, Incorporated; UP Energy Corporation; UPL Pinedale, L.L.C.; UPL Three Rivers Holdings, L.L.C., Debtors,
Ultra Petroleum Corporation; Keystone Gas Gathering, L.L.C.; Ultra Resources, Incorporated; Ultra Wyoming, Incorporated; Ultra Wyoming LGS, Incorporated; Up Energy Corporation; UPL Pinedale, L.L.C.; UPL Three Rivers Holdings, L.L.C., Appellants,
v.
Ad Hoc Committee of Unsecured Creditors of Ultra Resources, Incorporated; OpCo Noteholders, Appellees.

No. 17-20793
|
FILED January 17, 2019

Synopsis

Background: In surplus case, Chapter 11 debtors objected to noteholders' claim for make-whole premium and postpetition interest at contractual default rate. The United States Bankruptcy Court for the Southern District of Texas, Marvin P. Isgur, J., 575 B.R. 361, denied objection, and subsequently certified a direct appeal to the Court of Appeals, 2017 WL 4863015.

Holdings: The Court of Appeals, Andrew S. Oldham, Circuit Judge, held that:

addressing an issue of first impression for the court, a creditor is not "impaired" by a reorganization plan simply because it incorporates the Bankruptcy Code's disallowance provisions;

whether the pre-Code solvent-debtor exception to the general rule barring postpetition interest survived enactment of the section of the Bankruptcy Code requiring a bankruptcy court to disallow a claim to the extent that it seeks unmatured interest was a question for the bankruptcy court in the first instance, not for the Court of Appeals; and

the amount of postpetition interest to which noteholders were entitled would be determined by the bankruptcy court in the first instance.

Reversed in part, vacated in part, and remanded.

***536** Appeal from the United States Bankruptcy Court for the Southern District of Texas, Marvin P. Isgur, U.S. Bankruptcy Judge.

Attorneys and Law Firms

Paul D. Clement, George W. Hicks, Jr., C. Harker Rhodes, IV, Kirkland & Ellis, L.L.P., Washington, DC, for Appellants.

Andrew M. Leblanc, Esq., Milbank, Tweed, Hadley & McCloy, L.L.P., Washington, DC, Lauren Doyle, Dennis F. Dunne, Evan R. Fleck, Milbank, Tweed, Hadley & McCloy, L.L.P., New York, NY, William Richard Greendyke, Norton Rose Fulbright US, L.L.P., Houston, TX, for Appellee AD HOC COMMITTEE OF UNSECURED CREDITORS OF ULTRA RESOURCES, INCORPORATED.

David Bruce Salmons, Esq., Morgan, Lewis & Bockius, L.L.P., Washington, DC, Peter Sabin Willett, Esq., Amelia C. Joiner, Morgan, Lewis & Bockius, L.L.P., Boston, MA, Renee M. Dailey, Morgan, Lewis & Bockius, L.L.P., Hartford, CT, Andrew J. Gallo, Morgan, Lewis & Bockius, L.L.P., New York, NY, for Appellee OPCO NOTEHOLDERS.

David Andrew Baay, Garrett Gibson, Mark David Sherrill, Bankruptcy Counsel, Eversheds Sutherland (US), L.L.P., Houston, TX, Edward P. Christian, Eversheds Sutherland (US), L.L.P., Atlanta, GA, for Intervenors.

Before DAVIS, ENGELHARDT, and OLDHAM, Circuit Judges.

Opinion

ANDREW S. OLDHAM, Circuit Judge:

***537** These bankruptcy proceedings arise from exceedingly anomalous facts. The debtors entered bankruptcy insolvent and now are solvent. That alone makes them rare. But second, the debtors accomplished their unlikely feat by virtue of a lottery-like rise in commodity prices. The combination of these anomalies makes these debtors as rare as the proverbial rich man who manages to enter the Kingdom of Heaven.

The key legal question before us is whether the rich man's creditors are "impaired" by a plan that paid them everything allowed by the Bankruptcy Code. The bankruptcy court said yes. In that court's view, a plan impairs a creditor if it refuses to pay an amount the Bankruptcy Code independently disallows. In reaching that conclusion, the bankruptcy court split from the only court of appeals to address the question, every reported bankruptcy court decision on the question, and the leading treatise discussing the question. We reverse and follow the monolithic mountain of authority holding the Code—not the reorganization plan—defines and limits the claim in these circumstances.

Because the bankruptcy court saw things differently, it ordered the debtors to pay certain creditors a contractual Make-Whole Amount and postpetition interest at a contractual default rate. We vacate and remand those determinations for reconsideration.

I.

Ultra Petroleum Corporation ("Petroleum") is an oil and gas exploration and production company. To be more precise, it's a holding company. Petroleum's subsidiaries—UP Energy Corporation ("Energy") and Ultra Resources, Inc. ("Resources")—do the exploring and producing. Resources took on debt to finance its operations. Between 2008 and 2010, Resources issued unsecured notes worth $1.46 billion to various noteholders. And in 2011, it borrowed another $999 million under a Revolving Credit Facility. Petroleum and Energy guaranteed both debt obligations.

In 2014, crude oil cost well over $100 per barrel. But then Petroleum's fate took a sharp turn for the worse. Only a year and a half later, a barrel cost less than $30. The world was flooded with oil; Petroleum and its subsidiaries were flooded with ***538** debt. On April 29, 2016, the companies voluntarily petitioned for reorganization under Chapter 11. *See* 11 U.S.C. § 301(a). No one argues the companies filed those petitions in bad faith. *See id.* § 1112(b).

During bankruptcy proceedings, however, oil prices rose. Crude oil approached $80 per barrel, and the Petroleum companies became solvent again. So, the debtors proposed a rare creature in bankruptcy—a reorganization plan that (they said) would compensate the creditors in full. As to creditors with claims under the Note Agreement and Revolving Credit Facility (together, the "Class 4 Creditors"), the debtors would pay three sums: the outstanding principal on those obligations, pre-petition interest at a rate of 0.1%, and post-petition interest at the federal judgment rate. *In re Ultra Petroleum Corp.*, No. 4:16-bk-32202, ECF No. 1308-1 at 25–26 (Bankr. S.D. Tex. 2017). Accordingly, the debtors elected to treat the Class 4 Creditors as "unimpaired." Therefore, they could not object to the plan. 11 U.S.C. § 1126(f).

The Class 4 Creditors objected just the same. They insisted their claims *were* impaired because the plan did not require the debtors to pay a contractual Make-Whole Amount and additional post-petition interest at contractual default rates.

Under the Note Agreement, prepayment of the notes triggers the Make-Whole Amount. That amount is designed "to provide compensation for the deprivation of" a noteholder's "right to maintain its investment in the Notes free from repayment." A formula defines the Make-Whole Amount as the amount by which "the Discounted Value of the Remaining Scheduled Payments with respect to the Called Principal" exceeds the notes' "Called Principal." Remaining scheduled payments include "all payments of [the] Called Principal and interest ... that would be due" after prepayment (if the notes had never been prepaid). And the discounted value of those payments is keyed to a "Reinvestment Yield" of 0.5% over the total anticipated return on comparable U.S. Treasury obligations.

Under the Note Agreement, petitioning for bankruptcy automatically renders the outstanding principal, any accrued interest, and the Make-Whole Amount "immediately due and payable." Failure to pay immediately triggers interest at a default rate of either 2% above the normal rate set for the note at issue or 2% above

J.P. Morgan's publicly announced prime rate, whichever is greater.

The Revolving Credit Facility does not contain a make-whole provision. But it does contain a similar acceleration clause that made the outstanding principal and any accrued interest "automatically ... due and payable" as soon as Resources petitioned for bankruptcy. And it likewise provides for interest at a contractual default rate—2% above "the rate otherwise applicable to [the] Loan"—if Resources delayed paying the accelerated amount.

Under these two agreements, the creditors argued the debtors owed them an additional $387 million—$201 million as the Make-Whole Amount and $186 million [1] in post-petition interest. Both sides chose to kick the can down the road. Rather than force resolution of the impairment issue at the plan-confirmation stage, the parties stipulated the bankruptcy court could resolve the dispute by deeming the creditors ***539** unimpaired and confirming the proposed plan. Meanwhile, the debtors would set aside $400 million to compensate the Class 4 Creditors if necessary "to render [the creditors] Unimpaired." The bankruptcy court agreed and confirmed the plan.

After confirmation, the parties (and the bankruptcy court) turned back to the question of impairment. The debtors acknowledged the plan did not pay the Make-Whole Amount or provide post-petition interest at the contractual default rates. But they insisted the Class 4 Creditors were not "impaired" because federal (and state) law barred them from recovering the Make-Whole Amount and entitled them to receive post-petition interest only at the federal judgment rate.

The Bankruptcy Code provides that a class of claims is not impaired if "the [reorganization] plan ... leaves unaltered the legal, equitable, and contractual rights to which such claim ... entitles the holder." 11 U.S.C. § 1124(1). Elsewhere the Code states that a court should disallow a claim "to the extent that [it seeks] unmatured interest." *Id.* § 502(b)(2). The debtors argued the Make-Whole Amount qualified as unmatured interest. But even if it didn't, they said, it was an unenforceable liquidated damages provision under New York law. In either case, something *other than* the reorganization plan itself—the Bankruptcy Code or New York contract law—prevented the Class 4 Creditors from recovering the disputed amounts.

The debtors' argument as to post-petition interest was much the same: The Bankruptcy Code entitles creditors, at most, to post-petition interest at the "legal rate," not the rates set by contract. 11 U.S.C. § 726(a)(5). And the legal rate, they said, is the federal judgment rate under 28 U.S.C. § 1961. Once again, the Code—not the plan—limited the Class 4 Creditors' claims.

The bankruptcy court rejected the premise that it must bake in the Code's provisions before asking whether a claim is impaired. Instead it concluded unimpairment "requires that [creditors] receive all that they are entitled to under state law." *In re Ultra Petroleum Corp.*, 575 B.R. 361, 372 (Bankr. S.D. Tex. 2017). In other words, if a plan does not provide the creditor with all it would receive under state law, the creditor is impaired even if the Code disallows something state law would otherwise provide outside of bankruptcy. So, the bankruptcy court asked only whether New York law permits the Class 4 Creditors to recover the Make-Whole Amount (concluding it does), and whether the Code limits the contractual post-petition interest rates (concluding it does not). *Id.* at 368–75. It never decided whether the Code disallows the Make-Whole Amount as "unmatured interest" under § 502(b)(2) or what § 726(a)(5)'s "legal rate" of interest means. It ordered the debtors to pay the Make-Whole Amount and post-petition interest at the contractual rates to make the Class 4 Creditors truly unimpaired.

The debtors sought a direct appeal to this Court (rather than the district court) because the case raises important and unsettled questions of law. *See* 28 U.S.C. § 158(d)(2)(A). The bankruptcy court agreed, and so did we. *In re Ultra Petroleum Corp.*, No. 16-32202, 2017 WL 4863015, at *1 (Bankr. S.D. Tex. Oct. 26, 2017). On appeal, we review those legal questions anew. *In re Positive Health Mgmt.*, 769 F.3d 899, 903 (5th Cir. 2014).

II.

We consider first whether a creditor is "impaired" by a reorganization plan simply because it incorporates the Code's disallowance provisions. We think not.

***540** A.

Chapter 11 lays out a framework for proposing and confirming a reorganization plan. Confirmation of the plan "discharges the debtor from any debt that arose before the date of such confirmation." 11 U.S.C. § 1141(d)(1). Because discharge affects a creditor's rights, the Code generally requires a debtor to vie for the creditor's vote first. *Id.* § 1129(a)(8). And when it does, the creditor may vote to accept or reject the plan. *Id.* § 1126(a). But the creditor's right to vote disappears when the plan doesn't actually affect his rights. If the creditor is "not impaired under [the] plan," he is "conclusively presumed to have accepted" it. *Id.* § 1126(f). The question, then, is whether the Class 4 Creditors were "impaired" by the plan.

Let's start with the statutory text. Section 1124(1) says "a class of claims or interests" is not impaired if "the plan ... leaves unaltered the [claimant's] legal, equitable, and contractual rights." The Class 4 Creditors spill ample ink arguing their rights have been altered. But that's both undisputed and insufficient. The plain text of § 1124(1) requires that "the plan" do the altering. We therefore hold a creditor is impaired under § 1124(1) only if "*the plan*" itself alters a claimant's "legal, equitable, [or] contractual rights."

The only court of appeals to address the question took the same approach. In *In re PPI Enterprises (U.S.), Inc.*, a landlord (creditor) argued the reorganization plan of his former tenant (debtor) impaired his claim because it did not pay him the full $4.7 million of rent he was owed over the life of the lease. 324 F.3d 197, 201–02 (3d Cir. 2003). The Third Circuit disagreed. Because the Bankruptcy Code caps lease-termination damages under § 502(b)(6), the plan merely reflected the *Code's* disallowance. *Id.* at 204. At the end of the day, "a creditor's claim outside of bankruptcy is not the relevant barometer for impairment; we must examine whether the plan itself is a source of limitation on a creditor's legal, equitable, or contractual rights." *Ibid.* It simply did not matter the landlord "might have received considerably more if he had recovered on his leasehold claims before [the debtor] filed for bankruptcy." *Id.* at 205. The debtor's plan gave the landlord everything the law entitled him to once bankruptcy began, so he was unimpaired.

Decisions from bankruptcy courts across the country all run in the same direction. *See, e.g.*, *In re Tree of Life Church*, 522 B.R. 849, 861–62 (Bankr. D.S.C. 2015); *In re RAMZ Real Estate Co.*, 510 B.R. 712, 717 (Bankr. S.D.N.Y. 2014); *In re K Lunde, LLC*, 513 B.R. 587, 595–96 (Bankr. D. Colo. 2014); *In re Mirant Corp.*, No. 03-46590, 2005 WL 6440372, at *3 (Bankr. N.D. Tex. May 24, 2005); *In re Coram Healthcare Corp.*, 315 B.R. 321, 351 (Bankr. D. Del. 2004); *In re Monclova Care Ctr., Inc.*, 254 B.R. 167, 177 (Bankr. N.D. Ohio 2000), *rev'd on other grounds*, 266 B.R. 792 (N.D. Ohio 2001); *In re Am. Solar King Corp.*, 90 B.R. 808, 819–22 (Bankr. W.D. Tex. 1988). All agree that "[i]mpairment results from what the *plan* does, not what the [bankruptcy] statute does." *Solar King*, 90 B.R. at 819.

The creditors cannot point to a single decision that suggests otherwise. That's presumably why Collier's treatise states the point in unequivocal terms: "Alteration of Rights by the Code Is Not Impairment under Section 1124(1)." 7 COLLIER ON BANKRUPTCY ¶ 1124.03[6] (16th ed. 2018). "We are always chary to create a circuit split." *United States v. Graves*, 908 F.3d 137, 142 (5th Cir. 2018) (quotation omitted). That's especially true "in the context of bankruptcy, where uniformity is sufficiently important that our Constitution ***541** authorizes Congress to establish 'uniform laws on the subject of bankruptcies throughout the United States.' " *In re Marciano*, 708 F.3d 1123, 1135 (9th Cir. 2013) (Ikuta, J., dissenting) (quoting U.S. CONST. art. I, § 8, cl. 4). We refuse to create one today.

B.

The Class 4 Creditors' counterarguments do not move the needle. First, they focus on § 1124(1)'s use of the word "claim." They note the Code elsewhere speaks of "*allowed* claims." *See, e.g.*, 11 U.S.C. §§ 506(a)(1), 506(a)(2), 510(c)(1), 1126(c). Then they suggest the absence of "allowed" in § 1124(1) means "claim" there refers to the claim *before* the Code's disallowance provisions come in and trim its edges.

But the broader statutory context cuts the other way. Section 1124 is not just (or even primarily) about the allowance of claims. It is about rights—the "legal, equitable, and contractual rights to which [the] claim ... entitles the holder." *Id.* § 1124(1). That means we judge

impairment after considering everything that defines the scope of the right or entitlement—such as a contract's language or state law. *See In re Energy Future Holdings Corp.*, 540 B.R. 109, 121 (Bankr. D. Del. 2015); 11 U.S.C. § 502(b)(1). Even the bankruptcy court recognized this to some extent because it asked whether New York law permitted the Noteholders to recover the Make-Whole Amount. *See Ultra Petroleum*, 575 B.R. at 368–72. "The Bankruptcy Code itself is a statute which, like other statutes, helps to define the legal rights of persons." *Solar King*, 90 B.R. at 819–20.

Finding no help in § 1124(1)'s statutory text, the Class 4 Creditors turn to the legislative history of a different provision. In 1994, Congress repealed § 1124(3), which provided that a creditor's claim was not impaired if the plan paid "the *allowed amount* of such claim." 11 U.S.C. § 1124(3) (1988) (emphasis added). This proves, they say, that disallowance should now play no role in the impairment analysis.

Even for those who think legislative history can be relevant to statutory interpretation, this particular history is not. It does not say that every disallowance causes impairment. Rather, Congress repealed § 1124(3) in response to a specific bankruptcy court decision. *See In re New Valley Corp.*, 168 B.R. 73 (Bankr. D.N.J. 1994). That decision held unsecured creditors who received their allowed claims from a solvent debtor, but who did not receive post-petition interest, were unimpaired. *Id.* at 77–80. In debating the proposed repeal of § 1124(3), the House Judiciary Committee singled out *New Valley* by name as the justification for the repeal. *See* H.R. Rep. No. 103-835, at 47–48 (1994) (citing *New Valley* and explaining the intent to repeal § 1124(3) "to preclude th[e] unfair result" of "den[ying] the right to receive post petition interest"). It is noteworthy the committee report does not cite other bankruptcy cases—such as *Solar King*—that addressed Code impairment under § 1124(1). That is why the Third Circuit rejected appellees' legislative-history argument in *PPI* and held the repeal of § 1124(3) "does not reflect a sweeping intent by Congress to give impaired status to creditors more freely outside the postpetition interest context." 324 F.3d at 207 (noting the committee report cited *New Valley* but not *Solar King*).

Next, the Class 4 Creditors attempt to distinguish *PPI*. True, that case involved disallowance under § 502(b)(6), not § 502(b)(2). But that's a distinction without a difference. *See In re W.R. Grace & Co.*, 475 B.R. 34, 161–62 (Bankr. D. Del. 2012); *Energy Future*, 540 B.R. at 122.

***542** Section 502 states that "the court ... *shall allow* [a] claim in [the requested] amount, *except to the extent that*" any one of nine conditions apply. If any of the enumerated conditions applies, the court shall not allow the relevant portion of the claim. *PPI* reasoned that where one of those conditions applies, the Code—not the plan—impairs the creditors' claims. *See* 324 F.3d at 204. That reasoning applies with equal force to § 502(b)(2).

The Class 4 Creditors (like the bankruptcy court) also point to the mechanics of Chapter 11 discharge to suggest the plan itself, not the Code, is doing the impairing. They note the Code's disallowance provisions are carried into effect only if the plan is confirmed, and "confirmation of the plan ... discharges the debtor from any debt that arose before" confirmation. 11 U.S.C. § 1141(d). In one sense, plan confirmation limits creditors' claims for money by discharging underlying debts. But in another sense, the Code limits the creditors' claims for money and imposes substantive and procedural requirements for plan confirmation. The Class 4 Creditors' argument thus begs the critical question: What is doing the work here? We agree with *PPI*, every reported decision identified by either party, and Collier's treatise. Where a plan refuses to pay funds disallowed by the Code, the Code—not the plan—is doing the impairing.

III.

That leaves the question whether the Code disallows the creditors' claims for the Make-Whole Amount and post-petition interest at the contractual default rates specified in the Note Agreement and the Revolving Credit Facility. The bankruptcy court never reached either question. The parties nevertheless urge us to reach them now. The creditors say their contracts entitle them to both amounts, and that their contracts should be honored under bankruptcy law's longstanding "solvent-debtor" exception. The debtors argue no such exception exists in modern bankruptcy law. And the debtors further argue both claims are governed by the Bankruptcy Code, not the pre-Code law or the parties' contracts.

A word of clarification at the outset regarding terminology: For almost three hundred years, bankruptcy law has recognized different kinds of "postpetition

interest." As relevant here, the first is part of an underlying debt obligation—like the rate specified in the Note Agreement (i.e., interest *as part of* a claim). Although such interest has a life before bankruptcy, it may continue to exist and accrue from when the debtor files a bankruptcy petition until the day he finally pays the underlying debt. The second is interest a creditor is entitled to recover as a consequence of receiving a bankruptcy award (i.e., interest *on* a claim). That interest never existed before bankruptcy; rather, it arises only after bankruptcy has transmogrified a debt obligation into a bankruptcy award. Both types of interest are "post-petition" in that they accrue after the petition is filed. But the parties use the phrase "post-petition interest" to refer exclusively to the latter type of interest. Unless otherwise indicated below, so do we.

With that understanding, we first consider the historical, pre-Code provenance of the solvent-debtor exception. Second, we consider the proper interpretation of the Code. Finally, we vacate and remand both questions to the bankruptcy court.

A.

In eighteenth-century England, only a creditor could kick-start bankruptcy proceedings by submitting a petition and an affidavit to the Lord Chancellor. (There was nothing like our voluntary debtor petition under Chapter 11. *See* ***543** 11 U.S.C. § 301; Bankruptcy Act of 1841, ch. 9, § 1, 5 Stat. 440, 441 (1841) (repealed 1843).) The Lord Chancellor, in turn, granted a commission to "wyse and honest discrete p[er]sons," who were tasked with administering the bankrupt's estate. An Acte Touchyng Orders for Bankruptes 1571, 13 Eliz. c. 7, § 2; *see generally The Case of Bankrupts* (1589), 76 Eng. Rep. 441; 2 Co. Rep. 25a (K.B.).[2] Although English bankruptcy law mollified (somewhat) the severity of the Romans,[3] it authorized the commissioners "to breake open the [bankrupt's] House" to seize him and all of his goods. An Acte for the Discripcion of a Banckrupt and Reliefe of Credytors 1623, 21 Jac. c. 19, § 7; *see* 2 WILLIAM BLACKSTONE, COMMENTARIES *479–80.

Several debtor-friendly rules softened things. Of critical importance, English law barred creditors from recovering any interest that accrued after the Lord Chancellor issued his commission. *Sexton v. Dreyfus*, 219 U.S. 339, 344, 31 S.Ct. 256, 55 L.Ed. 244 (1911). Although the bankrupt was liable for interest up to the commission date, if bankruptcy proceedings dragged on, he was not liable for interest accruing as a result of the delay those proceedings caused before the commissioners actually paid his creditors. *See Ex Parte Bennet* (1743), 26 Eng. Rep. 716, 717; 2 Atk. 527, 528 (Ch.); 1 WILLIAM COOKE, THE BANKRUPT LAWS 196–97 (6th ed. 1812) (citing *Ex Parte Wardell* (1787)). And after paying his creditors in full, the bankrupt could recover any surplus left in his estate. *See* An Acte for the Better Reliefe of the Creditors Againste Suche as Shall Become Bankrupts 1603, 1 Jac. c. 15, § 10; 13 Eliz. c. 7, § 4.

But there were exceptions to these rules. For example, where a secured creditor held collateral that produced interest during bankruptcy proceedings, he could recover that interest after the commission date. *See Ex Parte Ramsbottom* (1835), *in* 2 BASIL MONTAGU & SCROPE AYRTON, REPORTS OF CASES IN BANKRUPTCY 79, 83–84 (1836); *cf. Sexton*, 219 U.S. at 346, 31 S.Ct. 256. The oversecured-creditor rule was another example. Where a secured creditor held collateral that exceeded the value of the underlying debt, he could recover postpetition interest up to the value of his security. That is, a creditor with collateral valued at $500,000 to secure an underlying debt for $400,000 would be able to recover interest up to $100,000. *See Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 164, 67 S.Ct. 237, 91 L.Ed. 162 (1946); *but see* ***544** *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 246, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989) (observing this oversecured-creditor exception was "of more doubtful provenance").

Most importantly for our purposes, however, English bankruptcy law carved out an exception for solvent debtors. "In case of a surplus coming to a Bankrupt, Creditors have a right to interest wherever there is a contract for it appearing, either on the face of the security or by evidence." 1 COOKE, *supra*, at 198; 2 WILLIAM BLACKSTONE, COMMENTARIES *488. So, in 1743, the Lord Chancellor awarded "subsequent interest" to Stephen Evance's creditors because his estate was "able to pay it." *Bromley v. Goodere* (1743), 26 Eng. Rep. 49, 50–52; 1 Atk. 75, 77–80 (Ch.). Where the bankrupt's estate was solvent, the Lord Chancellor reasoned, awarding post-commission interest to some creditors would not prevent other creditors from receiving their "rateable portion." *Ibid.*; *see also Ex Parte Rooke* (1753), 26 Eng. Rep. 156, 157; 1 Atk. 244, 245 (Ch.).

But the fact the bankrupt's estate contained sufficient funds to pay creditors post-commission interest did not create a free-standing right to recover interest accruing throughout bankruptcy and up to payment. *Ex Parte Marlar* (1746), 26 Eng. Rep. 97, 98; 1 Atk. 150, 151 (Ch.). The solvent-debtor exception simply allowed any interest to *continue* accruing (at the contractual rate) if the creditor's contract already provided for interest on the underlying debt. *See Ex Parte Mills* (1793), 30 Eng. Rep. 640, 644; 2 Ves. jun. 295, 303 (Ch.); *accord Nicholas v. United States*, 384 U.S. 678, 682 n.9, 86 S.Ct. 1674, 16 L.Ed.2d 853 (1966). Thus, English law conceived of post-commission interest as part and parcel of the underlying debt obligation, not something external to the obligation that the creditor received as a consequence of recovering from the bankrupt's estate. In other words, the solvent-debtor exception permitted interest that was *part of* a creditor's claim, not interest *on* a claim.

American bankruptcy law is codified against this background. The Constitution authorizes Congress "[t]o establish ... uniform Laws on the subject of Bankruptcies throughout the United States." U.S. CONST. art. I, § 8, cl. 4. When Congress first exercised that power to adopt permanent federal bankruptcy legislation in 1898, it borrowed extensively from this English history. *See* Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549; *cf.* THOMAS COOPER, THE BANKRUPT LAW OF AMERICA, COMPARED WITH THE BANKRUPT LAW OF ENGLAND (1801) (noting earlier American law, on which the 1898 Act was based, closely tracked English bankruptcy law). Ever since, "we [have] naturally assume[d] that the fundamental principles upon which [England's bankruptcy system] was administered were adopted by us when we copied th[at] system." *Sexton*, 219 U.S. at 344, 31 S.Ct. 256. That includes the fundamental principle barring creditors from recovering interest accruing after the petition (or commission) date—and the exceptions to that principle. *See Am. Iron & Steel Mfg. Co. v. Seaboard Air Line Ry.*, 233 U.S. 261, 266–67, 34 S.Ct. 502, 58 L.Ed. 949 (1914).

B.

In 1978, Congress enacted an entirely new Bankruptcy Code. *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. §§ 101–1532). The Code adopted many of these early bankruptcy principles, but with some important modifications.

For starters, Congress codified the general rule barring post-petition interest ***545** that is *part of* a creditor's claim in 11 U.S.C. § 502(b)(2). That provision disallows a claim "to the extent that [it seeks] unmatured interest." Numerous courts have recognized this connection between § 502(b)(2) and the pre-Code rule. *See, e.g.*, *Leeper v. Pa. Higher Educ. Assistance Agency*, 49 F.3d 98, 100–01 (3d Cir. 1995); *In re Fesco Plastics Corp.*, 996 F.2d 152, 155–56 (7th Cir. 1993); *In re Monahan*, 497 B.R. 642, 647 (1st Cir. B.A.P. 2013).

Congress also codified the exception for oversecured creditors. *See United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 373, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988). Section 506(b) allows a creditor to recover interest if the value of his security "is greater than the amount of [his allowed secured] claim." And we have held that § 506(b) incorporates the "pre-Code case law" providing that the creditor is entitled to such interest at "the contract rate." *In re Laymon*, 958 F.2d 72, 75 (5th Cir. 1992).

At first blush, it appears Congress also codified the solvent-debtor exception—or something very much like it—in § 726(a)(5). *See In re Colortex Indus., Inc.*, 19 F.3d 1371, 1376 & n.4 (11th Cir. 1994). Section 726(a) lists a descending waterfall of priorities for distributing property in a Chapter 7 bankruptcy:

> (a) Except as provided in section 510 of this title, property of the estate shall be distributed—
>
> (1) first, in payment of claims of the kind specified in ... section 507 ... ;
>
> (2) second, in payment of any allowed unsecured claim, other than a claim of a kind specified in paragraph (1), (3), or (4) of this subsection ... ;
>
> (3) third, in payment of any allowed unsecured claim proof of which is tardily filed under section 501(a) of this title ... ;
>
> (4) fourth, in payment of any allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive

> damages, arising before the earlier of the order for relief or the appointment of a trustee ... ;
>
> (5) fifth, in *payment of interest at the legal rate from the date of the filing of the petition, on any claim* paid under paragraph (1), (2), (3), or (4) of this subsection; and
>
> (6) sixth, to the debtor.

11 U.S.C. § 726 (emphasis added). If the debtor's estate is sufficient to pay items 1 through 4, then creditors should also get post-petition interest (item 5) before the debtor can recover any surplus (item 6).

This principle applies in Chapter 11 cases too. Chapter 7 and Chapter 11 bankruptcies generally run along different tracks. [4] But § 1129(a)(7), commonly referred to as the "Best Interests of Creditors" test, incorporates § 726(a)'s waterfall provision. *See* 7 COLLIER, *supra*, ¶ 1129.02[7][c][iii]. It requires a Chapter 11 plan to provide that impaired creditors "will receive ... not less than the amount that [they] would ... receive if the debtor were liquidated under chapter 7," 11 U.S.C. § 1129(a)(7)(A)(ii), including postpetition ***546** interest at "the legal rate," *id.* § 726(a)(5).

But § 726(a)'s solvent-debtor exception differs from the pre-Code version in several respects. First, although the pre-Code version applied to all creditors with a contractual entitlement to interest, the Code's version applies to all creditors in Chapter 7 cases, but only impaired creditors in Chapter 11 cases. Section 1129(a)(7) states it applies only "with respect to [an] impaired class of claims." Its plain text does not apply to *unimpaired* claims. *See Cont'l Sec. Corp. v. Shenandoah Nursing Home P'ship*, 193 B.R. 769, 776 (W.D. Va. 1996); *In re Seatco, Inc.*, 257 B.R. 469, 480 (Bankr. N.D. Tex. 2001); 7 COLLIER, *supra*, ¶ 1129.02[7][a] ("[I]f a class is unimpaired under section 1124, its members do not get the protections of the best interest test; instead they are left to their unaltered legal or equitable rights.").

Second, the Code changed the source of recoverable post-petition interest. The pre-Code solvent-debtor exception allowed creditors to recover interest *as part of* a claim. The Code, by contrast, requires solvent debtors to pay post-petition interest *on* a claim.

The Code itself highlights the difference. And we infer a distinction in meaning from Congress's distinction in language. *See, e.g.*, ANTONIN SCALIA & BRYAN A. GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXTS 170 (2012). For example, § 726(a)(2) refers to payment of a "claim." So too does § 502(b)(2), which refers to a "*claim* ... for unmatured interest." These provisions prove Congress knew how to write about interest *as part of* a claim when it wanted to. By contrast, § 726(a)(5) provides for "payment of [postpetition] interest ... *on* [*the*] *claim*." In doing so, Congress necessarily determined the type of post-petition interest contemplated in § 726(a)(5) is not *part of* the claim itself. [5]

Third, the Code may have changed the applicable interest rate. The pre-Code exception allowed interest at the contract rate because it permitted interest fixed by contract to continue accruing according to the contract's terms. *Ex Parte Marlar*, 27 Eng. Rep. at 98. The Code, however, requires "interest at the legal rate." 11 U.S.C. § 726(a)(5). Some courts interpret "the legal rate" to mean a rate set by statute. *See, e.g.*, *In re Cardelucci*, 285 F.3d 1231, 1234 (9th Cir. 2002) (citing 28 U.S.C. § 1961). Others interpret "the legal rate" to mean one set by contract. *See, e.g.*, *In re Schoeneberg*, 156 B.R. 963, 972 (Bankr. W.D. Tex. 1993). If the former are correct, the Code changed the pre-Code rate.

One final note: Pre-Code, our Court pioneered the incorporation of England's solvent-debtor exception into American bankruptcy law. But we did so, at least in part, based on concerns that a solvent debtor could file a voluntary petition in bad faith to avoid paying interest and that ***547** a creditor would be powerless to stop the then-*ex-parte* bankruptcy proceedings. *See Johnson v. Norris*, 190 F. 459, 463 (5th Cir. 1911). While the pre-Code law left creditors "powerless to resist" a bad-faith petition filed by a solvent debtor, *ibid.*, today the Code allows creditors to seek dismissal based on a debtor's bad faith, *see* 11 U.S.C. § 1112(b)(1); *In re Krueger*, 812 F.3d 365, 373 (5th Cir. 2016).

C.

The next question is what this historical and statutory backdrop means for the creditors' claims to the Make-Whole Amount and post-petition interest. As we explain

below, the creditors can recover the Make-Whole Amount if (but only if) the solvent-debtor exception survives Congress's enactment of § 502(b)(2). We doubt it did. But we vacate and remand to allow the bankruptcy court to answer the question in the first instance.

The creditors' entitlement *vel non* to post-petition interest is even murkier. The parties agree the creditors are entitled to some post-petition interest, but they disagree about the rate—namely, whether it is the federal judgment rate or something higher. To the extent the creditors seek postpetition interest *as part of* their claims, they run into the same issues that affect the Make-Whole Amount. To the extent they seek post-petition interest *on* their claims, the pre-Code solvent-debtor exception does not countenance it. And the Code itself says nothing about post-petition interest on unimpaired claims for Chapter 11 cases. It is not clear then what should fill that vacuum, and the bankruptcy court said nothing about it. We therefore vacate the award of post-petition interest and remand that question to the bankruptcy court as well.

1.

We start with whether the Make-Whole Amount is disallowed by § 502(b)(2). That Code provision requires a bankruptcy court to disallow a claim "to the extent that [it seeks] unmatured interest." 11 U.S.C. § 502(b)(2). Our precedent in turn defines § 502(b)(2)'s "unmatured interest" by looking to economic realities, not trivial formalities. *In re Pengo Indus., Inc.*, 962 F.2d 543, 546 (5th Cir. 1992) ("economic reality," "economic fact," "economic equivalent"). Section 502(b)(2) thus disallows any claim that is the economic equivalent of unmatured interest. *Ibid.*

The debtors make a compelling argument the Make-Whole Amount is one such disallowed claim. We are persuaded by three aspects of the debtors' argument.

First, the Make-Whole Amount is the economic equivalent of "interest." The purpose of a make-whole provision "is to compensate the lender for lost interest." 4 COLLIER, *supra*, ¶ 502.03[3][a]; *see In re MPM Silicones, L.L.C.*, 874 F.3d 787, 801–02 & n.13 (2d Cir. 2017) (The "make-whole premium was intended to ensure that [noteholders] received additional compensation to make up for the interest they would not receive if the Notes were redeemed prior to their maturity date."); *In re Energy Future Holdings Corp.*, 842 F.3d 247, 251 (3d Cir. 2016) (similar); *In re Ridgewood Apartments of DeKalb Cty., Ltd.*, 174 B.R. 712, 720 (Bankr. S.D. Ohio 1994) (similar). So too here. The Make-Whole Amount is calculated by subtracting the accelerated principal from the discounted value of the future principal and interest payments. That captures the value of the interest the Noteholders would have eventually received if the Notes had not been prepaid. *See* ***548** *In re Doctors Hosp. of Hyde Park, Inc.*, 508 B.R. 697, 705 (Bankr. N.D. Ill. 2014). [6]

Second, the interest for which the Make-Whole Amount compensates was "unmatured" when the debtors filed their Chapter 11 petitions. Section 502(b)'s disallowance provisions apply "as of the date of the filing of the petition." On that day, the debtors did not owe the Make-Whole Amount or the underlying interest. The Note Agreement's acceleration clause doesn't change things because it operates as an *ipso facto* clause by keying acceleration to, among other things, the debtor's decision to file a bankruptcy petition. *See In re Lehman Bros. Holdings Inc.*, 422 B.R. 407, 414–15 (Bankr. S.D.N.Y. 2010); *Ipso Facto Clause*, BLACK'S LAW DICTIONARY 957 (Del. 10th ed. 2014). And the parties agree that an *ipso facto* clause is unenforceable. "[W]hether interest is considered to be matured or unmatured for the purpose of [§ 502(b)(2)] is to be determined without reference to any *ipso facto* bankruptcy clause in the agreement creating the claim." 4 COLLIER, *supra*, ¶ 502.03[3][b]; *see* H.R. Rep. No. 95-595, at 352–53 (1977); *In re ICH Corp.*, 230 B.R. 88, 94 (N.D. Tex. 1999). The Class 4 Creditors' only response is the acceleration clause is not an *ipso facto* clause because it could also be triggered by something other than a bankruptcy petition. They cite nothing for that proposition.

Third, those decisions taking a different view are unpersuasive. Some courts have concluded § 502(b)(2) does not cover make-whole provisions on the assumption "they fully mature pursuant to the provisions of the contract." *In re Outdoor Sports Headquarters, Inc.*, 161 B.R. 414, 424 (Bankr. S.D. Ohio 1993); *see In re Skyler Ridge*, 80 B.R. 500, 508 (Bankr. C.D. Cal. 1987). But *ipso facto* clauses count for nothing when deciding maturity under § 502(b)(2). Others have concluded make-whole provisions are better viewed as liquidated damages, rather than unmatured interest. *In re Trico Marine Servs., Inc.*, 450 B.R. 474, 480–81 (Bankr. D. Del. 2011); *In re Lappin*

Elec. Co., 245 B.R. 326, 330 (Bankr. E.D. Wis. 2000). But those categories are not mutually exclusive. *Doctors Hosp.*, 508 B.R. at 706.

The Class 4 Creditors' most persuasive response is that none of these arguments applies to a *solvent* debtor. First, they try the "absolute priority rule," insisting it bars a solvent debtor from paying stockholders any surplus before fully compensating its creditors. That is only half right. For starters, the absolute priority rule applies when asking whether a plan is "fair and equitable" in a cram-down scenario. 11 U.S.C. § 1129(b)(1). It is not a freewheeling exception requiring a debtor to pay amounts the Code otherwise prohibits. But more importantly, the rule itself builds in the Code's disallowance provisions. It stands for the proposition that a plan "may not allocate any property whatsoever to any junior class ... unless all senior classes consent, or unless such senior classes receive property equal in value to the full amount of their *allowed claims*." 7 COLLIER, *supra*, ¶ 1129.03[4][a][i] (emphasis added). Thus, the Class 4 Creditors simply beg the question whether § 502(b)(2) disallows the Make-Whole ***549** Amount; if it does, the absolute priority rule takes that into account.

Their second argument fares better: If the pre-Code solvent-debtor exception survives in the background of the Code, then the Class 4 Creditors have a point. As explained above in Part III.A, English bankruptcy law gave the creditors of a solvent debtor the "right to interest wherever there is a contract for it." 1 COOKE, *supra*, at 198; *accord Bromley*, 26 Eng. Rep. at 50–52. And it appears undisputed the Class 4 Creditors would have a contractual right outside of bankruptcy to the interest specified in the Make-Whole Amount. Therefore, the pre-Code solvent-debtor exception would operate as a carve-out from § 502(b)(2)'s general bar on unmatured interest —in much the same way the exception operated as a carve-out from the pre-Code rule barring contract interest after the commission date.

The only question then is whether the pre-Code solvent-debtor exception survives the enactment of § 502(b)(2). As discussed above in Part III.B, Congress carefully incorporated some pre-Code principles but not others. And those principles it did incorporate, Congress sometimes modified. It might be true Congress chose not to codify the solvent-debtor rule as an absolute exception to § 502(b)(2). *See, e.g.*, *Ron Pair Enters.*, 489 U.S. at 243–46, 109 S.Ct. 1026; *Timbers of Inwood*, 484 U.S. at 373, 108 S.Ct. 626. On the other hand, we sometimes presume congressional silence leaves undisturbed certain long-established bankruptcy principles. *See, e.g.*, *Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot.*, 474 U.S. 494, 500–01, 106 S.Ct. 755, 88 L.Ed.2d 859 (1986); *Kelly v. Robinson*, 479 U.S. 36, 44–47, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986). The bankruptcy court's resolution of the Code-impairment question prevented it from considering these arguments. "[M]indful that we are a court of review, not of first view," we will not make the choice ourselves. *Cutter v. Wilkinson*, 544 U.S. 709, 718 n.7, 125 S.Ct. 2113, 161 L.Ed.2d 1020 (2005).

One last note on our remand of the Make-Whole Amount. Much of the pre-Code law regarding solvent debtors —including our 1911 decision in *Johnson*—appears motivated by concerns over bad-faith filings. That is, courts worried that without the solvent-debtor exception, solvent debtors would seek bankruptcy protection in bad faith simply to avoid paying their debts. And many of the creditors' arguments before our Court have the same flavor. But Chapter 11 addresses this problem by creating a motion-to-dismiss procedure for bad-faith filings. *See* 11 U.S.C. § 1112(b); *In re Integrated Telecom Express, Inc.*, 384 F.3d 108, 112, 118–20 (3d Cir. 2004). And as far as the record reveals, the Class 4 Creditors never availed themselves of that procedure or complained it was insufficient. That is presumably because the debtors are both solvent and good-faith filers. We trust the bankruptcy court on remand also will consider what effect (if any) § 1112(b) has on the solvent-debtor exception (if any exists).

2.

Finally, we turn to post-petition interest. Both parties agree the creditors are entitled to *some* post-petition interest. That agreement is founded on Congress's past amendments to the Code. "Before 1994, [the Code] specified that a creditor receiving full payment of an 'allowed claim' was not impaired." *PPI*, 324 F.3d at 205 (citing former 11 U.S.C. § 1124(3) (1988)). When "one bankruptcy court held that § 1124(3) allowed a solvent debtor to pay the 'allowed' claims of unsecured creditors in full, excluding postpetition interest, without risking impairment," Congress responded ***550** by repealing § 1124(3). *Id.* at 205–06 (citing *New Valley*, 168 B.R. at 77–

80). Courts have interpreted the relevant legislative history as establishing that a creditor denied post-petition interest is "impaired, entitling [that creditor] to vote for or against the plan of reorganization." *Id.* at 206 (quoting H.R. Rep. No. 103-835, at 47–48).

Even if this entitles the Class 4 Creditors to at least some post-petition interest, it does not establish how much. The parties point to only one Code provision setting a rate for post-petition interest on awards, § 726(a)(5), but for the reasons discussed above, it does not apply to the creditors here. Thus, we look outside the Code to see if a more general rule controls.

Here, the pre-Code practice provides no help. As far as we can tell, English bankruptcy law provided no right at all to interest on a bankruptcy award. *See Ex Parte Marlar*, 26 Eng. Rep. at 98. It merely allowed contractual interest that was accruing prior to the solvent debtor's bankruptcy to continue accruing at the contractual rate. *See Ex Parte Mills*, 30 Eng. Rep. at 644. That is why English creditors could recover post-petition interest *as part of* a claim (perhaps like the Make-Whole Amount). But it also is why the solvent-debtor exception does not answer whether the creditors can recover post-petition interest *on* a claim—or how much. As far as we can tell, the modern concept of post-petition interest *on* a claim had no analogy under pre-Code law.

In our view, that leaves two potential paths. The first is the general post-judgment interest statute. *See* 28 U.S.C. § 1961. Section 1961(a) allows interest "on any money judgment in a civil case recovered in a district court" and sets a rate by reference to certain Treasury yields. Courts have applied this provision to bankruptcy proceedings on the theory bankruptcy courts are units of district courts. *See In re Dow Corning Corp.*, 237 B.R. 380, 385–86 (Bankr. E.D. Mich. 1999) (collecting cases). Courts have also treated bankruptcy claims as equivalent to judgments entered on the day the petition was filed. *See, e.g.*, *Wasserman v. City of Cambridge*, 151 B.R. 4, 6 n.2 (D. Mass. 1993) ("Upon the filing of bankruptcy, claims of creditors are treated as the functional equivalent of a federal judgment against the estate's assets."); *Dow Corning*, 237 B.R. at 393 ("Several courts have stated that a creditor's claim is deemed to be a 'judgment' entered on the date of the petition."); *In re Melenyzer*, 143 B.R. 829, 833 (Bankr. W.D. Tex. 1992) ("From and after the petition date, then, creditors hold the equivalent of a federal judgment against estate assets, enforceable only in federal court .... Bankruptcy gives all creditors what amounts to a judgment against the debtor as of the filing date."). This has led at least one court to conclude § 1961 requires post-petition interest on the award at the judgment rate from the date the petition was filed. *See Dow Corning*, 237 B.R. at 393 ("If these courts are correct, then both 28 U.S.C. § 1961(a) and § 726(a)(5) start the interest clock running from the same date. This viewpoint is sensible given that unsecured claims are valued as of the petition date.").

One benefit of applying § 1961 to the claims of unimpaired creditors in Chapter 11 proceedings could be uniformity. If, as some courts hold, § 726(a)(5)'s reference to "the legal rate" incorporates the rate from § 1961, then all bankruptcy creditors could receive post-petition interest at the same rate. *See Dow Corning*, 237 B.R. at 393. On the other hand, a bankruptcy award back-dated to the petition filing date may prove a poor analogy to ordinary judgments. Or perhaps Congress's failure ***551** to apply § 1961 to unimpaired Chapter 11 creditors is meaningful. *See* SCALIA & GARNER, *supra*, at 93 (explaining "[t]he principle that a matter not covered [by a statute] is not covered").

A second potential path is equity. Bankruptcy courts have long been thought of as courts of equity, especially when it comes to awarding interest. *See Vanston Bondholders*, 329 U.S. at 164, 67 S.Ct. at 241; *Consolidated Rock Prods. Co. v. Du Bois*, 312 U.S. 510, 527–28, 61 S.Ct. 675, 85 L.Ed. 982 (1941). That might not help where the Code's reticulated statutory scheme has displaced the bankruptcy courts' equitable authority. *See, e.g.*, *Law v. Siegel*, 571 U.S. 415, 421, 134 S.Ct. 1188, 188 L.Ed.2d 146 (2014) ("[W]hatever equitable power remains in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." (quotation omitted)). But by all accounts, the Code says nothing about post-petition interest on unimpaired Chapter 11 claims. So equity might say something.

After all, we know the Class 4 Creditors are by stipulation unimpaired, and § 1124(1) says unimpaired creditors retain their "legal, equitable, and contractual rights." The creditors here have no *legal* right to post-petition interest at the default rates. They do not point to a New York law requiring them to receive post-petition interest. Nor do they have a *contractual* right to such

interest. The contractual rates at issue here governed interest paid on amounts owed under the contract, not interest on a bankruptcy award. The contracts did not purport to fix an interest rate that would govern if the parties proceeded to protracted litigation, obtained the equivalent of a "judgment" in bankruptcy court, and then a court awarded interest. But they might have an *equitable* right to post-petition interest. At least one well-reasoned bankruptcy decision has so held: For creditors "to be unimpaired the plan must provide that the Court may award post-petition interest at an appropriate rate if it determines to do so under its equitable power." *Energy Future*, 540 B.R. at 124. Because the bankruptcy court in this case erred in its Code-impairment analysis, we do not have the benefit of its wisdom on these questions.

* * *

As we have explained, Code impairment is not the same thing as plan impairment. Because the bankruptcy court found otherwise, it did not address whether the Code disallows the Make-Whole Amount or post-petition interest, and if not, how much the debtors must pay the Class 4 Creditors. To secure plan confirmation, the parties stipulated the debtors would do whatever is necessary to make the creditors unimpaired. The bankruptcy court, therefore, must make that stipulation a reality. For that reason and others explained above, we REVERSE in part, VACATE in part, and REMAND for further proceedings consistent with this opinion.

All Citations

913 F.3d 533, 66 Bankr.Ct.Dec. 187

Footnotes

1 This amount includes $106 million in interest on the outstanding principal under the notes, $14 million in interest on the Make-Whole Amount, and $66 million in interest on the outstanding principal under the Revolving Credit Facility, all accruing after the debtors filed their petitions.

2 Because the Lord Chancellor appointed commissioners promptly upon determining the debtor qualified as a bankrupt, the commission marked the beginning of bankruptcy proceedings. *See* Stephen J. Lubben, *A New Understanding of the Bankruptcy Clause*, 64 CASE WESTERN RES. L. REV. 319, 331–32 (2013); Louis Edward Levinthal, Note, *The Early History of English Bankruptcy*, 67 U. PENN. L. REV. 1, 17 (1919). For that reason, the commission date is functionally equivalent to the petition date under our present bankruptcy laws.

3 As England's foremost jurist once said, we "like not Lawes written in bloode." Edward Coke, Speech in the House of Commons (May 24, 1621), *in* 5 COMMONS DEBATES, 1621, at 176 (Wallace Notestein et al. eds., 1935). *Compare* LEGES DUODECIM TABULARUM tbl. III, law X *in* 1 S.P. SCOTT, THE CIVIL LAW 64 (2001) ("Where a party is delivered up to several persons, on account of a debt, after he has been exposed in the Forum on three market days, they shall be permitted to divide their debtor into different parts, if they desire to do so."), *with* An Acte for the Discripcion of a Banckrupt and Reliefe of Credytors 1623, 21 Jac. c. 19, § 6 (A bankrupt may be "sett upon the Pillory in some publique Place, for the space of Two Houres, and have one of his or her Eares nayled to the Pillory and cutt off."); *but see* An Act to Prevent Frauds Frequently Committed by Bankrupts 1705, 4 & 5 Ann. c. 4, § 1 (authorizing punishment of death without the benefit of clergy for certain bankrupts).

4 Proceedings under Chapter 7 end in a fire sale, and the debtor is left a pile of ash. *See* 11 U.S.C. §§ 704(a)(1), 721. Proceedings under Chapter 11, however, are designed to reorganize—rather than liquidate—the debtor, which emerges capable of doing business. *See id.* §§ 1107–08, 1141.

5 Courts routinely talk about § 726(a)(5) as a present-day solvent-debtor "exception" to the general rule—now codified in § 502(b)(2)—barring post-petition interest. *See, e.g.*, *Fesco Plastics*, 996 F.2d at 155–56; *accord In re Shoen*, 176 F.3d 1150, 1153 n.2 (9th Cir. 1999) (McKeown, J., dissenting). For convenience, we have used that terminology here in discussing whether, and if so how, the pre-Code exception survives in the post-Code world. But as the preceding discussion makes clear, that framing misses a key nuance. Section 726(a)(5) is not really an exception to § 502(b)(2) at all because the provisions are talking about two different kinds of interest: Section 502(b)(2) (the general rule) bars interest as part of a claim, while § 726(a)(5) (the so-called exception) allows interest on a claim. *See Energy Future*, 540 B.R. at 113.

6 The Class 4 Creditors' principal objection is the Make-Whole Amount is not *actually* interest. For example, they note it compensates the Noteholders not for the use of their money, but for Resources' forbearance from using that money. They add it is paid in a lump sum rather than earned over time. But as already discussed, our precedent interpreting §

502(b)(2) does not require the Make-Whole Amount to *be* unmatured interest; it requires only that it walk, talk, and act like unmatured interest. *See Pengo*, 962 F.2d at 546. Neither party suggests this precedent has been overruled.

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912 F.3d 291
United States Court of Appeals, Fifth Circuit.

In the MATTER OF: BUCCANEER RESOURCES, L.L.C., Buccaneer Energy Limited, Buccaneer Energy Holdings, Incorporated, Buccaneer Alaska Operations, L.L.C., Buccaneer Alaska, L.L.C., Kenai Land Ventures, L.L.C., Buccaneer Alaska Drilling, L.L.C., Buccaneer Royalties, L.L.C., Kenai Drilling, L.L.C., Debtors
Meridian Capital CIS Fund; Meridian Capital International Fund; Fred Tresca; Randy A. Bates; Branta II, L.L.C., Appellants
v.
Curtis Burton, Appellee

No. 18-40003
|
FILED January 4, 2019

Synopsis

Background: Corporate Chapter 11 debtor's former chief executive officer (CEO) filed state court action against secured lender to recover on tortious interference theory for using influence that it possessed over debtor to persuade debtor to fire the CEO. Cause of action was removed to federal court as related to debtor's bankruptcy case, and the former CEO moved to remand. The United States Bankruptcy Court for the Southern District of Texas determined that tortious interference claim was a direct claim that belonged to the former CEO, and the District Court, Hayden Head, 2017 WL 6209915, affirmed and remanded to state court. Secured lender appealed.

The Court of Appeals, Gregg Costa, Circuit Judge, held that tortious interference claim sought to recover for direct injury to the CEO that was not derivative of any harm that the secured lender's conduct may have caused to debtor, and thus was not a cause of action that belonged to the estate.

Affirmed.

***292** Appeal from the United States District Court for the Southern District of Texas, Hayden Head, U.S. District Judge

Attorneys and Law Firms

Thomas Kirkendall, Law Office of Tom Kirkendall, The Woodlands, TX, for Appellants Meridian Capital CIS Fund, Meridian Capital International Fund.

Joshua Walton Wolfshohl, Esq., Aaron J. Power, Jonna Noel Summers, Porter & Hedges, L.L.P., Houston, TX, for Appellants Fred Tresca, Randy A. Bates, Branta II, L.L.C.

Richard M. Schechter, Richard Schechter, P.C., Houston, TX, Chris Alan Stacy, Houston, TX, for Appellee Curtis Burton.

Before WIENER, SOUTHWICK, and COSTA, Circuit Judges.

Opinion

GREGG COSTA, Circuit Judge:

Before Buccaneer Resources LLC filed for bankruptcy, it fired its CEO, Curtis Burton. Burton filed a claim for breach of contract in the bankruptcy, but later dropped that and filed a tortious interference with contract claim in state court against Buccaneer's secured creditor, Meridian Capital CIS Fund. Meridian removed the case to federal court, arguing that the claim belonged in the bankruptcy. The bankruptcy court disagreed, sending the tortious interference claim back to state court. The district court affirmed.

The dispute about jurisdiction turns on whether the tortious interference claim belongs to Burton, in which case it should be heard in state court, or to the debtor Buccaneer, in which case bankruptcy court is the proper forum. Because the claim seeks to recover for a direct injury to Burton, we agree with the bankruptcy and district courts that he can pursue it in state court.

I.

Burton was Buccaneer's CEO from the company's founding in 2006 until May 2014. Along with affiliated entities, Buccaneer was an oil exploration and production

company. Although companies that hit gushers get the attention, Buccaneer had the more common experience for oil and gas ventures: it never struck it big.

***293** As Buccaneer's fortunes dwindled, Meridian Capital CIS Fund became its most important secured creditor. By January 2014, it held all of Buccaneer's senior debt, securing it with a blanket lien over all Buccaneer's assets. The purchase of senior debt rescued Buccaneer from immediate insolvency, but it was only a temporary life raft—Buccaneer filed for Chapter 11 in May.

Shortly before that bankruptcy filing, Buccaneer fired Burton. Burton says the termination violated the terms of his contract and triggered a penalty worth three years of his base salary. He contends that Meridian was involved in Buccaneer's decision. According to Burton, three of the four Buccaneer board members, that is every board member other than Burton, had close ties to Meridian —some were even appointed by it. In emails, Meridian referred to intriguing assets Buccaneer controlled, assets that could benefit Meridian if Buccaneer was operated by a new CEO it controlled. Burton also alleges that Meridian contacted the board and informed it that Meridian would no longer invest or loan money to Buccaneer unless Burton was fired.

Burton filed a claim in the bankruptcy but later withdrew it. Buccaneer and Meridian eventually reached a settlement in which Buccaneer released Meridian from any potential claims Buccaneer may have had for $10 million. That settlement was incorporated into Buccaneer's bankruptcy plan.

Burton then filed this suit against Meridian (and several affiliates and individual advisors for the fund) in state court, alleging tortious interference with contract as well as tagalong claims of conspiracy and assisting. Meridian removed the case to the bankruptcy court, arguing that the claims belonged to the debtor's estate and were thus released in the Buccaneer-Meridian settlement. The bankruptcy court mostly disagreed, concluding that the tortious interference claim belonged to Burton and thus should be litigated in state court. The district court later remanded all claims to state court as the follow-on claims depended on the success of the tortious interference claims. This appeal followed, and the parties agree that the fate of all claims turns on what we decide about the tortious interference claim.

II.

Whether the bankruptcy estate or a creditor can pursue a claim against third parties is a recurring issue in bankruptcy law. *In re Seven Seas Petroleum, Inc.*, 522 F.3d 575 (5th Cir. 2008), instructs us to focus on whether the creditor has suffered a direct injury or one that is derivative of an injury to the debtor. *Id.* at 584. If the harm to the creditor comes about only because of harm to the debtor, then its injury is derivative, and the claim is property of the estate. *Id.*; *see also* 11 U.S.C. § 541(a)(1). In that situation, only the bankruptcy trustee has standing to pursue the claim for the estate so that all creditors will share in any recovery. *Seven Seas*, 522 F.3d at 584.

As for direct-injury claims that belong to a particular creditor or group of creditors, the simple case is when the claim does not involve any harm to the debtor. These cannot be part of the estate. *Id.* at 584 (quoting *In re Educators Grp. Health Trust*, 25 F.3d 1281, 1284 (5th Cir. 1994)). But even when the conduct harms the debtor, the creditor may also have a claim if its asserted injury does not flow from injury to the debtor. This means that the estate and a creditor may have separate claims against a third party arising out of the same events. *Seven Seas*, 522 F.3d at 585, 590; *Educators Trust*, 25 F.3d at 1284–85. To pursue a claim on its own ***294** behalf, a creditor must show this direct injury is not dependent on injury to the estate. [1]

Our caselaw illustrates the difference between direct and derivative injuries. *See Seven Seas*, 522 F.3d at 585–86. The unsecured bondholders in *Seven Seas* sued a consulting firm that provided false oil reserve estimates. *Id.* at 585. The bondholders relied on those estimates when deciding to invest. *Id.* That induced reliance did not injure the debtor, only the bondholders, so the injury was direct and belonged to the creditors. *Id.* A similar example involved school districts that were creditors of a bankrupt health benefits provider. Their claim that a third-party health plan administrator misled them alleged a direct injury not dependent on harm to the debtor. *Educators Trust*, 25 F.3d at 1285 (remanding the claim involving a direct injury to state court).

Other cases demonstrate derivative injuries. When third parties lured a debtor into transferring them oil and gas

assets, they eliminated the creditors' hopes of recovering a portion of the value of those assets. *In re Lothian Oil, Inc.*, 531 F. App'x 428, 439 (5th Cir. 2013). The creditors' injury (reduced bankruptcy recovery) derived from injury to the debtor (the loss of estate assets), so only the estate could sue the third parties. *Id.* at 439–40. Similarly, an alter ego suit that attempted to pierce the corporate veil and recover assets improperly moved through the corporate structure belonged only to the estate. *See In re Schimmelpenninck*, 183 F.3d 347, 358 (5th Cir. 1999). And only the estate owned a claim against a bank for aiding the debtor's managers to encumber the debtor's assets with new liens. *See In re R.E. Loans*, 2013 WL 1265205, at *5 (N.D. Tex. Mar. 28, 2013). Once again, the plaintiff's injury of a reduced bankruptcy recovery derived from harm to the debtor—that caused by the liens—so the estate owned the claim. *Id.*

Unlike these derivative injuries, the harm to Burton from an improper firing without the required severance does not depend on any harm to the debtor. In fact, the termination of his employment contract may have saved Buccaneer money. Meridian says it did. The injury to Burton flowed through Buccaneer's actions—allegedly taken at Meridian's request—but not through an injury to the debtor. Viewed another way, there is no reason why the estate should recover for a third party's tortious conduct that did not injure the bankrupt company. *See In re Zale Corp.*, 62 F.3d 746, 755 (5th Cir. 1995) (holding that bankruptcy court did not have jurisdiction over bad-faith claims third parties brought against a debtor's insurer because "the claims are not property of the estate and they have no effect on the estate"); *Steinberg v. Buczynski*, 40 F.3d 890, 893 (7th Cir. 1994) ("When a third party has injured not the bankrupt corporation itself but a creditor of that corporation, the trustee in bankruptcy cannot ***295** bring suit against the third party."). This may be more evident when the third party allegedly committed a personal-injury tort as opposed to an economic one; the Seventh Circuit used the hypothetical of a creditor's slip-and-fall claim against a third party that no one would contend belongs to the estate. *Id.* at 892. But the principle is the same when the third party engages in tortious conduct that causes a direct economic harm to a particular creditor. *Id.* at 893; *Seven Seas*, 522 F.3d at 587. The tortious interference claim thus belongs to Burton. [2]

Meridian tries to avoid this straightforward conclusion by arguing that the tortious interference claim is really one for lender liability in disguise. It says the injury was improper control of Buccaneer, and that improper control led to Burton's termination, making it a derivative harm. But whatever label is put on Burton's claim, what matters is the nature of the injury he is seeking compensation for. *Seven Seas*, 522 F.3d at 584. As we just explained, Burton's termination did not depend on Buccaneer suffering an injury. It may be that Buccaneer was also injured by Meridian's control of its board (Meridian paid $10 million to settle Buccaneer's claims after all, but a debtor and creditor can have separate claims arising from the same conduct. *Seven Seas*, 522 F.3d at 585. As long as the injury a creditor is pursuing against a third party does not stem from the depletion of estate assets, the injury is a direct one that does not belong to the estate.

In re Dexterity Surgical, Inc., 365 B.R. 690 (Bankr. S.D. Tex. 2007), does not counsel otherwise. Most of the six claims a debtor's minority shareholders brought against the majority shareholder and members of the debtor's board were classically derivative—they sought to recover for harm resulting from the defendants' looting the debtor's assets. *Id.* at 696–99. A business entity largely owned by the same shareholders also brought a claim alleging the defendants tortiously interfered with a contract it had with the debtor. The interference claim did not add any new allegations; it just realleged the facts that gave rise to the breach of fiduciary duty claims involving derivative harm. *Id.* at 702. The bankruptcy court concluded that the mere relabeling of a derivative claim did not change its nature. *Dexterity Surgical* also went on to note weaknesses in the tortious interference theory. *Id.* at 700–01 (doubting the plaintiff could "show that Defendants acted so contrary to Dexterity's best interest that the Court could find that Defendants' actions were purely personally motivated"). That may be in tension with our later guidance that courts deciding who owns a claim should not consider whether the claim "will ultimately prove to be legally or factually valid." *Seven Seas*, 522 F.3d at 585.

Unlike the claim in *Dexterity Surgical*, Burton's is not a tortious interference claim in name only. It asserts an injury that does not depend on harm to the debtor. And the question of who owns the claim does not depend on whether Burton could ***296** survive a motion to dismiss, much less prevail at trial. *Id.* Because the tortious interference claim Burton presses is based on an injury

that is independent of any injury to the debtor, it belongs to him.

III.

That we readily find Burton's tortious interference claim to involve a direct rather than derivative injury does not mean that we have no concerns about the nature of the claim asserted. Our doubt, however, is not because we think the tortious interference claim might belong to the debtor. In this respect, this case does not resemble *Seven Seas* even though both sides agree that case provides the relevant framework. In *Seven Seas* both the creditors and the debtor had claims against consulting firms. *See Seven Seas*, 522 F.3d at 585. So the dispute was about which one was the proper plaintiff (or whether both could be). *Id.* But here the debtor was another potential *defendant*. Burton elected to pursue what could have been a bankruptcy claim as a tort claim against a solvent third party.

It thus seems at first blush that such an action could undermine the point of bankruptcy—to gather creditors together in one forum and settle their claims at once. Then again, Burton dismissed his claim against the estate and a successful lawsuit against a third party would not harm the debtor's reorganization. Nor would it be unfair to other creditors given our conclusion that the injury Burton is seeking to remedy is not derived from harm to the estate. In contrast, damages for an injury to the estate should be recovered by the trustee so all creditors can share in the proceeds. So perhaps the *Seven Seas* dichotomy between direct and derivative injuries also resolves many of our qualms about a claim that could be brought by a creditor against either the debtor or a third party. If a creditor decides to pursue a claim against a third party outside of bankruptcy, the requirement that the claim arise from a direct injury to that creditor ensures the separate suit does not put a reorganized debtor or other creditors in a worse position than they would otherwise be.

So the concern at most seems to be that claims like Burton's may chill secured creditors like Meridian from offering distressed financing and influencing prebankruptcy management. [3] But Meridian has pointed to no authority immunizing a nondebtor third party from being sued for any wrongful conduct merely because the plaintiff might have also had a remedy against the debtor. Both parties framed this case as one governed by the *Seven Seas* inquiry. Under that framework, the injury to Burton is a direct one. Whether a secured creditor like Meridian should enjoy any special protection from suit beyond the defenses parties ordinarily possess (and the limits that cost and uncertainty place on the filing of suits) is not a question before us in this limited jurisdictional ***297** dispute asking whether Burton or the estate owns the tort claim.

* * *

Because the tortious interference claim alleging a direct injury to Burton is not property of the estate, there is no basis for bankruptcy court jurisdiction. The order remanding this case to state court is AFFIRMED.

All Citations

912 F.3d 291, 66 Bankr.Ct.Dec. 178

Footnotes

1 Other circuits engage in a similar inquiry that focuses on whether the asserted injury is "inseparable from, and predicated upon, a legal injury to the estate." *In re Bernard L. Madoff Inv. Securities LLC*, 740 F.3d 81, 92–93 (2nd Cir. 2014); *see also In re Icarus Holding, LLC*, 391 F.3d 1315, 1321 (11th Cir. 2004) (looking at whether the creditor alleged only an "indirect" harm that flowed from the debtor's injury); *Steinberg v. Buczynski*, 40 F.3d 890, 893 (7th Cir. 1994) ("When a third party has injured not the bankrupt corporation itself but a creditor of that corporation, the trustee in bankruptcy cannot bring suit against the third party."). Instead of using the direct/derivative terminology, some courts speak in terms of whether a creditor's injury is "personal" (direct) or "general" (derivative). *See, e.g.*, *Lumpkin v. Envirodyne Indus., Inc.*, 933 F.2d 449, 463 (7th Cir. 1991). Regardless of the differing labels, the inquiry seems to be the same.

2 At oral argument, Meridian tried to characterize the injury as derivative by saying that the depletion of Buccaneer's assets is what made it unable to pay Burton his severance. Buccaneer's financial situation may have prevented it from paying Burton any damages, but Burton's injury (his termination) did not flow from any depletion of assets. Instead, as alleged, Meridian induced the breach to benefit Buccaneer. To illustrate this point, consider a scenario in which Buccaneer's

fortunes improved after firing Burton. Burton would still have had an injury even if Buccaneer might have been able to compensate him for it. The termination injury Burton asserts thus does not depend on a depletion of Buccaneer's assets.

3 Secured creditors play an in increasing role in the lead up to bankruptcy. Especially those with liens over all the assets of the estate can influence board members during that time because the assumption is that they will be the equity owners after it. *See* David A. Skeel, *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917, 926–27, 931 (2003); Douglas G. Baird, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 697–98 (2003). Many commenters see this control as beneficial because it encourages companies to reorganize quickly and efficiently. *See id.* at 934; *see also* Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 785 (2002) ("We are not troubled by such a shift in bankruptcy practice. As a comparative matter, the senior lender who will not be paid in full will more likely exercise control in a sensible fashion than will managers whose net worth depends on continuation ....").

End of Document

2019 WL 268578
United States Bankruptcy Court,
W.D. Tennessee, Western Division.

IN RE William H. THOMAS, Jr., aka Bill Thomas, Debtor. SSN: xxx – xx – xxxx

Case No. 16-27850-K
|
Signed January 18, 2019

Attorneys and Law Firms

Jessica Lyn Indingaro, Shelby County Office of the Mayor, Adam M. Langley, Jonathan T. Skrmetti, Butler Snow LLP, William H. Thomas, Jr., William H. Thomas, Jr. Law, Memphis, TN, for Debtor.

Michael E. Collins, Robert Miller, Manier & Herod, P.C., Nashville, TN, for Trustee.

MEMORANDUM AND ORDER RE "CLEAR CHANNEL OUTDOOR, INC.'S RENEWED MOTION FOR APPOINTMENT OF CHAPTER 11 TRUSTEE" COMBINED WITH NOTICE OF THE ENTRY THEREOF

David S. Kennedy, UNITED STATES CHIEF BANKRUPTCY JUDGE

INTRODUCTION

***1** Clear Channel Outdoor, Inc. ("Clear Channel"), a prepetition judicial lien creditor, filed the instant motion under 11 U.S.C. § 1104(a)(1)-(2) ("Motion") originally seeking the appointment of a Chapter 11 trustee with "limited powers." [1] Creditor, the Tennessee Department of Transportation ("TDOT"), and Tennison Brothers, Inc., also a prepetition judicial lien creditor ("Tennison Brothers"), each filed a notice of joinder regarding Clear Channel's Motion. [2] This Motion resulted in three written objections or responses thereto filed by Mrs. Lynn Schadt Thomas ("Mrs. Thomas"), William H. Thomas, Jr., aka Bill Thomas, the above-named debtor ("Mr. Thomas"), and the United States Trustee for Region 8 respectively. It is noted that the United States Trustee also filed a "Motion to Dismiss or, in the Alternative, Convert Chapter 11 Case to Case Under Chapter 7." The attorneys for all of the immediate parties in interest participated in the oral arguments for and against the Motion that were held and heard in open court on January 15, 2019.

The ultimate question for judicial determination here is whether "cause" exists as contemplated under 11 U.S.C. § 1104(a)(1), such that a Chapter 11 trustee should be appointed in lieu of Mr. Thomas continuing to serve as a debtor in possession, or whether such appointment of a trustee is in the interests of creditors as contemplated under 11 U.S.C. § 1104(a)(2).

This is a core proceeding under 28 U.S.C. § 157(b)(2)(A). Accordingly, the Court has both the statutory and constitutional authority to hear and determine these proceedings subject to the statutory appellate provisions of 28 U.S.C. § 158(a)(1) and Part VIII ("Bankruptcy Appeals") of the Federal Rules of Bankruptcy Procedure. The following shall constitute the Court's findings of fact and conclusions of law in accordance with Rule 7052 of the Federal Rules of Bankruptcy Procedure.

DISCUSSION OF BACKGROUND FACTS AND INFORMATION AND PROCEDURAL HISTORY OF THIS CHAPTER 11 CASE

This Chapter 11 case arises out of more than a decade of litigation and legalistic bickering primarily between Mr. Thomas and the two judgment creditors, Clear Channel and Tennison Brothers. As such, a detailed discussion of the relevant pre- and postpetition background facts and procedural history of this Chapter 11 case may be helpful here and may be summarized as follows.

Mr. Thomas, who currently serves here as a Chapter 11 debtor in possession, is also a licensed attorney and businessman. He is a resident of the State of Tennessee and also a resident of the State of Florida, and has business ventures in Memphis, Tennessee. Clear Channel is a Delaware corporation with its principal address located in San Antonio, Texas; however, at all relevant times here, Clear Channel owned and/or operated billboard advertising structures in Shelby County, Tennessee. Tennison Brothers is a corporation with its principal office located in Memphis, Tennessee. Clear Channel and Tennison Brothers are pre-Chapter 11 Tennessee judicial lien creditors of Mr. Thomas. TDOT is a Tennessee

governmental agency with its headquarters located in Nashville, Tennessee, who also is a creditor in this case. Mrs. Thomas is the wife of Mr. Thomas and also an asserted creditor here.

***2** On September 11, 2017, Clear Channel filed a motion seeking the appointment of a Chapter 11 trustee under 11 U.S.C. § 1104(a)(1) and (2) ("First Trustee Motion"). Dkt. No. 297. Thereafter, on September 18, 2017, Tennison Brothers filed a Notice of Joinder. Dkt. No. 303. An Objection thereto was filed by Mr. Thomas on September 25, 2017. Dkt. No. 308. The First Trustee Motion came to be heard by this Court on September 27, 2017, whereupon this Court at the early stages of this case denied the First Trustee Motion, but "without prejudice to a future motion being refiled for a change of circumstances not heretofore raised at this hearing." *See* Dkt. No. 311.

On October 26, 2018, Glankler Brown, PLLC ("Glankler Brown"), Memphis counsel for Mr. Thomas in this Chapter 11 case, filed an "Emergency Motion to Withdraw as the Attorney of Record." Dkt. No. 441. As reasons for seeking to withdraw, Glankler Brown asserted that numerous disagreements had arisen with Mr. Thomas and that Mr. Thomas "insisted on taking positions which are contrary to the advice of counsel and had on occasion taken positions which [they] consider repugnant or imprudent." *See* Dkt. No. 441, p. 2. After notice, that matter came to be heard before this Court on October 30, 2018; and an Order granting the withdrawal was entered on November 20, 2018, without opposition. Dkt. No. 461.

Ten days later, on November 30, 2018, Clear Channel filed a "Renewed Motion for Appointment of Chapter 11 Trustee," requesting the appointment of a Chapter 11 trustee with "limited powers." Dkt. No. 472, p. 2. On December 6, 2018, TDOT filed a Notice of Joinder to the Motion, Dkt. No. 480, and on December 7, 2018, Tennison Brothers filed the same, Dkt. No. 481 (collectively referred to as "Related Joinders"). An Objection to the Motion and Related Joinders was filed by Mrs. Thomas on December 11, 2018, putting forth three main arguments: (1) there is no cause for the appointment of a Chapter 11 trustee and Creditors have failed to demonstrate same; (2) Clear Channel and Tennison Brothers do not have a pecuniary interest in the bankruptcy estate and their interests should be disregarded for purposes of the analysis under § 1104(a)(2); and (3) Mrs. Thomas is preparing to file a confirmable Chapter 11 creditor plan. Dkt. No. 493. On December 13, 2018, the United States Trustee filed a Response to the Motion stating that it takes no position on the Motion, but that "[i]f the Court concludes to direct the appointment of a Chapter 11 trustee, the codified scheme in the Bankruptcy Code and Rules should not be altered with respect to the rights, powers and duties of a trustee appointed under 11 U.S.C. § 1104(a)." Dkt. No. 496, p. 3. It is important to note that the United States Trustee also filed a motion to dismiss this case or, in the alternative, to convert the Chapter 11 case to a liquidating case under Chapter 7. Dkt. No. 497. Mr. Thomas filed a "Response" to the Motion and Related Joinders on December 14, 2018, alleging three main issues: (1) objecting to the appointment of a Chapter 11 trustee "because creditors Clear Channel Outdoor and Tennison Brothers have failed to set forth any change in circumstances since their last Motions for the Appointment of a Trustee were denied"; (2) asserting that such creditors had a right to file their own plan of reorganization but have not done so; and (3) incorporating the objection of Mrs. Thomas by suggesting that the claims of Clear Channel and Tennison Brothers "should be subordinated or denied based upon their punitive nature to all claims of unsecured creditors." Dkt. No. 501.

All of these matters came before this Court on December 18, 2018, for a combined pre-trial conference, whereupon each interested party had the opportunity to, *inter alia*, provide a general overview of their positions and arguments. It should be noted that at the pre-trial conference Clear Channel orally amended its Motion by eliminating its request for the appointment of a Chapter 11 trustee with limited powers and agreeing with the United States Trustee's position that, if appointed, it should be a Chapter 11 trustee with full powers and duties. This oral amendment has now been reduced to writing and filed with the Court. *See* Dkt. No. 520 ("Clear Channel submits that the appointment of a Chapter 11 Trustee with all powers and authority allowed under the Federal Rules of Bankruptcy Procedure is the proper course of action to move this bankruptcy to conclusion."). Tennison Brothers and TDOT orally agreed with the United States Trustee's position as well. This Court held a hearing on the merits on the instant Motion, Related Joinders, objections, and responses thereto on January 15, 2019. All attorneys representing the interested parties were present at the hearing. After notice and

opportunity for a hearing, all matters were taken under advisement. Before discussing the Motion, the Court felt it may be somewhat beneficial to provide a more detailed summary of the extensive background history including the legalistic bickering among Clear Channel, Tennison Brothers, TDOT, and Mr. Thomas to exhibit their relationships with one another.

Clear Channel, Tennison Brothers, and Mr. Thomas

***3** Clear Channel and Tennison Brothers entered into a lease agreement ("Lease") on August 19, 2004, for the erection of a billboard on Tennison Brothers' property located at 450 North Bellevue, Memphis, Tennessee 38105 ("Tennison Brothers Site"). *See Tennison Bros. v. Thomas,* 556 S.W.3d 697, 704 (Tenn. Ct. App. 2017) (hereinafter "*Tennison II* ")). Within days of the execution of the Lease between Clear Channel and Tennison Brothers, Mr. Thomas entered into a written lease with Southern Millwork and Lumber Company, the owner of the real property adjacent to the Tennison Brothers Site. *Id.* Mr. Thomas also intended to construct a billboard on said real property. *Id.* At the time, the *Tennessee Billboard Regulation and Control Act* ("the *Billboard Act* ") required permits to be obtained prior to constructing a billboard. *Id.*; *see also* TENN. CODE ANN. § 54-21-101, *et seq.* However, because of the proximity of the two properties, only one party could be awarded a permit. *Id.*

On or about August 24, 2004, Clear Channel applied for and was granted a permit to erect its billboard on the Tennison Brothers Site by TDOT, which happened to be around the same day Mr. Thomas had applied for and was denied the same for the adjacent real property. *Id.* at 704-05. Mr. Thomas, then, requested an administrative hearing before TDOT concerning its decision to grant Clear Channel a permit instead of him. *Id.* at 705. The legal battle over who should be awarded a permit to construct a billboard lasted approximately two years and resulted in a loss for Mr. Thomas. *Id.* However, the Creditors as well as TDOT did not know that Mr. Thomas had already constructed a billboard on the adjacent real property without a permit issued by the State of Tennessee. *Id.* at 706. Upon learning this fact, a demand was made on Mr. Thomas to remove his billboard, but he refused. *Id.* This led to a lawsuit being filed by Tennison Brothers in the Chancery Court of Shelby County, Tennessee ("Chancery Court"), in which the complaint alleged, *inter alia*, that Mr. Thomas "illegally constructed [a] billboard [that] interferes with the construction of the billboard on the Plaintiff's property," and more specifically that Mr. Thomas "maliciously and intentionally" interfered with business relationships, induced breach of contract, and created a public nuisance by failing to remove the billboard. *Id.* at 706-07; *see also* Dkt. No. 123, Ex. 2 at ¶¶ 15, 19-22, 28-29, 33-35.

Tennison Brothers named Clear Channel as a third-party defendant in the lawsuit, in which it answered and filed a cross-complaint against Mr. Thomas asserting various causes of action, including intentional interference with its business relationship with Tennison Brothers and statutory inducement to breach a contract. *Id.* at 707; *see also* Dkt. No. 122, Ex. 1 at ¶¶ 19-25, 27, 29-36, 38-41. Apparently, Mr. Thomas consistently refused to adequately respond to discovery in the Shelby County Chancery Court matter, despite two prior court orders compelling him to do so. *Id.* at 707-08. As such, the Chancery Court entered an Order on November 20, 2009, striking Mr. Thomas's answer and entering a default judgment against him. *Id.* Moreover, approximately six months later, Mr. Thomas, once again, refused to participate in and produce discovery, thereby causing the Chancery Court to enter a second Order forbidding Mr. Thomas from presenting proof related to damages and only allowing him the opportunity to cross-examine witnesses presented by other parties related to damages. *Id.* at 708-09.

After the hearing on damages, the Chancery Court found that Tennison Brothers and Clear Channel did not provide sufficient proof to conclude that Mr. Thomas had an improper motive, as is required to support a claim of intentional interference with business relationships, and therefore no damages were awarded. *Id.* at 709-10. Both Tennison Brothers and Clear Channel appealed to the Tennessee Court of Appeals, and it reversed the Chancery Court's findings and conclusions. *Id.* at 710. The Tennessee Court of Appeals determined that Tennison Brothers and Clear Channel had properly pled, *inter alia*, the elements for intentional interference with business relationships, that the trial court erred by going outside the pleadings to consider the issue of liability since there were well-pled facts in the respective complaints, and that Mr. Thomas had admitted to his improper motive when the default judgment was entered against him. *Id.*; *see*

Tennison Bros. v. Thomas, 2014 WL 3845122, at *1 (Tenn. Ct. App. Aug. 6, 2014) (hereinafter "*Tennison I*").

***4** On remand from the Tennessee Court of Appeals, the Shelby County Chancery Court appointed a Special Master to calculate the amount and type of damages that should be awarded to Tennison Brothers and Clear Channel for Mr. Thomas's tortious actions. *Tennison II* at 711. Ultimately, the Chancery Court adopted the report of the Special Master in its entirety and entered a final judgment awarding damages to Tennison Brothers in the amount of $ 1,094,670.94 and Clear Channel in the amount of $ 3,906,000. *Id.* at 712.

Mr. Thomas appealed the Chancery Court's decision, and the Tennessee Court of Appeals affirmed the Chancery Court. *Id.* Mr. Thomas raised various issues on appeal, some of which were rejected and others of which were waived. *Id.* Particularly, it should be specifically noted here that the Tennessee Court of Appeals considered the fact that Mr. Thomas had received a favorable ruling in the United States District Court for the Western District of Tennessee that declared the Tennessee *Billboard Act* unconstitutional, and stated that "[o]nce again, we conclude that Thomas cannot pursue this argument on appeal due to the entry of default judgment against him." *Id.* at 730-31. The Tennessee Court of Appeals stated further as follows:

> Thomas claims that the district court's ruling regarding constitutionality renders the plaintiffs unable "to recoup under said unconstitutional provisions" in the future. However, the plaintiffs in this case are not attempting to "recoup" under the Billboard Act. They are entitled to damages for the tort claims set forth in their complaints, for which they obtained a default judgment.

Id. at 731 (emphasis added).

Clear Channel and Tennison Brothers have both filed proofs of claim in this Chapter 11 case based upon the prepetition judgments rendered by the Tennessee State Court on February 4, 2016, against Mr. Thomas. *See* Proof of Claim Nos. 4 and 7. However, Mr. Thomas now disputes these claims and has filed an objection to the claims (and the prepetition Tennessee State Court judgments) of both Clear Channel and Tennison Brothers in, for example, his official bankruptcy schedules, oral statements made in open court, and written pleadings filed with this Court. *See* Dkt. No. 451; *see also* Dkt. No. 39, Sch. E. In addition to the pending appeal regarding this Court's Memorandum and Opinion in Adversary Proceeding Nos. 16-00260 and 16-00261 rendering the prepetition State Court judgments non-dischargeable under 11 U.S.C. § 523(a)(6),[3] it is expressly noted that Mr. Thomas also has filed separate adversary proceedings in this Chapter 11 case under 11 U.S.C. §§ 547 and 550 seeking to determine if the prepetition State Court judgments were preferences under 11 U.S.C. § 547(b) or fraudulent transfers to Tennison Brothers and Clear Channel. *See* Adv. Proc. Nos. 17-00157 and 17-00158 herein. It should further be noted that Mr. Thomas has filed a "Motion for Summary Judgment" in each of the respective adversary proceedings as well as a "Combined Motion for Summary Judgment" in the main case regarding the prepetition State Court judgments.

TDOT and Mr. Thomas

As mentioned above, TDOT has been engaged in litigation with Mr. Thomas since August 27, 2004, when TDOT denied his application for a permit to construct a billboard. *Tennison II* at 704. It is noted that TDOT denied Mr. Thomas' application due to his request being in violation of TDOT Rules and Regulations 1680-02-03-.03(1)(a)(4)(i)(I)[4] and TDOT's prior approval granted to Clear Channel. *Id.* at 704-05. On December 1, 2004, Mr. Thomas appealed the denial of his application to an Administrative Law Judge, and as a result of such appeal, TDOT voided the permit it previously issued to Clear Channel to erect the billboard on the Tennison Brothers Site. *Id.* at 705. While on appeal, Mr. Thomas apparently constructed the billboard without first receiving permission from the State of Tennessee. *Id.* In addition, in December 2005, unperceived by the Creditors and TDOT, Mr. Thomas sold the unpermitted billboard to CBS Outdoor, who were under the impression that all matters involving the State permit had been resolved and that TDOT had been ordered to issue a permit. *Id.* It should be noted that over the span of the permit litigation, Mr. Thomas continued to participate in the TDOT administrative proceedings portraying the idea that he still held a lease on the property and owned the "illegally constructed" billboard. *Id.*

***5** On March 5, 2007, Administrative Law Judge, the Honorable Thomas G. Stovall, issued a written

ruling that TDOT had properly issued to Clear Channel permits to construct the Tennison Billboard and that the Thomas Billboard was illegally constructed and should be immediately removed. *Tennison I* at 12. After Judge Stovall issued his ruling on March 5, 2007, Mr. Thomas refused to remove the Thomas Billboard. Mr. Thomas then appealed the Order to the Honorable Gerald F. Nicely, the Commissioner of TDOT. *Id.* On July 31, 2007, the Commissioner of TDOT issued a Final Order upholding the Order issued by the Administrative Law Judge and held that the Thomas Billboard had been illegally constructed and should be immediately removed. *Id.* After the Commissioner of TDOT issued his ruling, Mr. Thomas nonetheless refused to remove the Thomas Billboard. *Id.* Since approximately 2006, TDOT sought to remove Mr. Thomas's signs that did not comply with the *Billboard Act* through a prior enforcement action in Chancery Court. *Thomas v. Schroer*, 248 F. Supp. 3d 868, 874 (W.D. Tenn. 2017), reconsideration denied September 20, 2017.

On March 25, 2013, Mr. Thomas filed his first lawsuit in federal court against only TDOT, asserting numerous causes of action including the challenging of the constitutionality of the Tennessee *Billboard Act* on First Amendment grounds (the "First Federal Suit"). *Id.*; *see Thomas v. Tennessee Dep't of Transp.*, 2013 WL 12099086 (W.D. Tenn. October 28, 2013) (dismissing the case and holding that TDOT is a state agency entitled to sovereign immunity under the Eleventh Amendment). However, while the First Federal Suit was on appeal, Mr. Thomas filed his second lawsuit against TDOT, instead this time naming multiple Tennessee state officials in their official capacities. *Schroer*, 248 F. Supp. 3d at 874-75; *see* Dkt. No. 197, Ex. A. The Second Federal Suit alleged that one of the many billboards he owned erected without a permit was entitled to First Amendment protection as a display of non-commercial speech. *Schroer*, 248 F. Supp. 3d at 875. On March 31, 2017, the Western District of Tennessee found the *Billboard Act* to be an unconstitutional, content-based regulation of speech. *Id.* at 894-95. Specifically, the District Court found that the *Billboard Act*, as applied to Mr. Thomas's non-commercial messages on one of his billboards (referred to as the "Crossroads Ford Sign"), was a violation of the United States Constitution by way of the First Amendment's Free Speech provision. *Id.* Thereafter, the Commissioner of TDOT filed a motion for reconsideration, but it was denied. *See Thomas v. Schroer*, 2017 WL 6489144, at *2 (W.D. Tenn. September 20, 2017). That suit is now on appeal and pending before the Sixth Circuit.

Aside from the aforementioned state court and federal court litigation, it should be noted that Mr. Thomas is also still engaged in a separate state court lawsuit with TDOT. Due to the contentious relationship, the State of Tennessee sought a restraining order, temporary injunction, declaratory judgment, and permanent injunction in the Chancery Court in Shelby County, Tennessee, back on March 2, 2007. It was assigned to the Honorable Chancellor Walter Evans: *see* case number CH-07454 therein. Numerous pleadings appear to have been filed in that case, and several appeals also seem to have been made to the Tennessee Court of Appeals and Tennessee Supreme Court regarding various matters. That Chancery Court suit is ongoing.

TDOT has filed a proof of claim in this Chapter 11 case based on violations of the *Billboard Act*. *See* Proof of Claim No. 5. However, Mr. Thomas has objected to this claim, Dkt. No. 385, and it is an ongoing contested matter pursuant to Bankruptcy Rule 9014(a). FED. R. BANKR. P. 9014(a). It should also be noted that TDOT and Mr. Thomas have filed various pleadings regarding discovery, all of which are currently pending and in dispute. *See* Dkt. Nos. 428, 429, 439, 449, 484, and 503.

LEGAL ANALYSIS

The Bankruptcy Code gives the court the authority to order the appointment of a Chapter 11 trustee under 11 U.S.C. § 1104(a). This section provides, in pertinent part, that:

> ***6** At any time after the commencement of the case but before confirmation of the plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee –
>
> (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or

> (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

11 U.S.C. § 1104(a). In fact, regardless of a party in interest, a bankruptcy court also has the power in appropriate cases to appoint a trustee *sua sponte*. [5] *See* 11 U.S.C. § 105(a). [6]

However, "it is settled that appointment of a trustee should be the exception, rather than the rule." *In re Sharon Steel Corp.*, 871 F.2d 1217, 1225 (3d Cir. 1989). "There is a strong presumption in Chapter 11 cases that the debtor-in-possession should be permitted to remain in control of the corporation absent a showing of need for the appointment of a trustee." *In re Natron Corp.*, 330 B.R. 573, 591 (Bankr. W.D. Mich. 2005) (citation omitted). This presumption is based on the facts that the debtor in possession has a strong sense of familiarity with the business and no trustee expense will be required, both of which will likely benefit the creditors as well as the estate. *In re Marvel Entm't Group*, 140 F.3d 463, 470 (3d Cir. 1998) (citing *Sharon Steel Corp.*, 871 F.2d at 1226 (citation omitted)). "The debtor-in-possession is a fiduciary of the creditors and, as a result, has an obligation to refrain from acting in a manner which could damage the estate, or hinder a successful reorganization." *Petit v. New England Mortg. Servs.*, 182 B.R. 64, 69 (D. Me. 1995) (internal quotations omitted). Accordingly, appointing a trustee in a Chapter 11 case is an extraordinary remedy. *See* 7 COLLIER ON BANKRUPTCY ¶ 1104.02[3][b][i] (16th ed. 2016); *see also Adams v. Marwil (In re Bayou Grp., LLC)*, 564 F.3d 541, 546 (2d Cir. 2009). Thus, the question of whether a trustee should be appointed in a Chapter 11 case must be considered by the court on a case-by-case basis considering a totality of the particular facts and circumstances, and the party moving for the appointment of a trustee must prove the need for such by clear and convincing evidence. [7] *Sharon Steel Corp.*, 871 F.2d at 1226.

***7** Section 1104(a)(1) of the Bankruptcy Code mandates the court to appoint a trustee in a Chapter 11 case upon, for example, a determination of "cause." *See Oklahoma Ref. Co. v. Blaik (In re Oklahoma Ref. Co.)*, 838 F.2d 1133, 1136 (10th Cir. 1988). Yet, "a determination of cause ... is within the discretion of the court." *Marvel Entm't*, 140 F.3d at 472 (quoting *Comm. of Dalkon Shield Claimants v. A.H. Robins Co.*, 828 F.2d 239, 242 (4th Cir. 1987)). It is important to note that section 1104(a)(1) does not provide an exhaustive list of "cause" for which a trustee may be appointed; but rather, it provides that the court shall order the appointment of a trustee "for cause, including fraud, dishonesty, incompetence, gross mismanagement of the debtor by current management ... or similar cause ..." *See* 11 U.S.C. § 102(3) (providing that the terms "includes" and "including" are not limiting). Additional factors a court may use to determine if "cause" exists include whether:

> (1) the alleged misconduct was material; (2) the debtor treated insiders and affiliated entities better or worse than other creditors and customers; (3) the debtor made pre-petition voidable preferences or fraudulent transfers; (4) the debtor was unwilling or unable to pursue causes of action belonging to the estate; (5) conflicts of interest on the part of management interfered with its ability to fulfill its fiduciary duties to the debtor; and (6) management engaged in self-dealing or squandering of corporate assets.

In re LHC, LLC, 497 B.R. 281, 292 (Bankr. N.D. Ill. 2013) (citing *In re Intercat, Inc.*, 247 B.R. 911, 921 (Bankr. S.D. Ga. 2000)); *accord Nartron Corp.*, 330 B.R. at 592. Although there is no Sixth Circuit authority interpreting the scope of the provisions of 11 U.S.C. § 1104, there indeed are a number of appellate courts that have ruled in this area. For example, the Third Circuit has found that intense, irreconcilable conflicts and acrimony between the debtor and creditors can rise to the level of "cause" under 11 U.S.C. § 1104(a)(1). *See Marvel Entm't*, 140 F.3d at 472-74 (concluding, among other things, that "there is no likelihood of any cooperation between the parties in the near future" and finding sufficient cause under § 1104(a)(1) to appoint a Chapter 11 trustee to facilitate the case). In addition, the Fifth Circuit has upheld the appointment of a Chapter 11 trustee under 11 U.S.C. 1104(a)(1) based on a finding of acrimony. *See Cajun Elec. Power Coop., Inc. v.*

Cent. Louisiana Elec. Coop., Inc. (In re Cajun Elec. Power Coop., Inc.), 74 F.3d 599, 600 (5th Cir. 1996) (adopting on rehearing the opinion of the dissent in 69 F.3d 746, 751 (5th Cir. 1995)), *cert. denied*, 519 U.S. 808 (1996) (stating that acrimony is cause to appoint a trustee "when the inherent conflicts extend beyond the healthy conflicts that always exist between debtor and creditor or ... when the parties 'begin working at cross-purposes' ").

In *Marvel Entertainment*, the Chapter 11 debtor in possession and the creditors had material conflicts of interests, severe acrimony, and took dramatically different stances on many issues, citing, among other things, the debtor in possession's institution of several adversary proceedings. 140 F.3d at 473. The Third Circuit adopted the reasoning of the Fifth Circuit in *Cajun Electric*, 74 F.3d at 600 (adopting dissent at 69 F.3d 751), which recognized that some debtor-creditor conflict is "deep-seeded" and so inherent that proceeding like a typical Chapter 11 case is virtually impossible. *Id.* The Third Circuit held that, given the fact that this is a complicated bankruptcy case coupled with strife-ridden history and acrimony, the appointment of a trustee to act as a neutral and efficient fiduciary was appropriate under both § 1104(a)(1) or (a)(2). *Id.* at 475. It should be noted, however, that the Third Circuit expressly held that "there is no per se rule by which mere conflicts or acrimony between debtor and creditor mandate the appointment of a trustee." *Id.* at 473. Instead, the Third Circuit stated that the court must look at the circumstances of the case and such determination must be made on a case-by-case basis. *Id.*

***8** Mr. Thomas, joining with Mrs. Thomas, argue that the Creditors, also including TDOT, have not meaningfully addressed any "cause" for the appointment of a Chapter 11 trustee and that "mere acrimony" is not sufficient cause. This Court, however, disagrees under the totality of the particular facts and circumstances existing in this case. Here, as in *Marvel Entertainment*, 140 F.3d at 473, and *Cajun Electric*, 74 F.3d at 600 (adopting dissent at 69 F.3d at 751), there is no reasonable likelihood of any cooperation among the parties in the foreseeable future, and the parties have been working at cross-purposes since this case was transferred to this Court. Simply put, the relationships here are very deeply-seeded with severe acrimony. Mr. Thomas, the Creditors, and TDOT have substantial differences of opinion regarding the outcome of the relevant matters before the Court. No party disputes that there is a long history of severe acrimony among the interested parties in this case (i.e., Mr. Thomas, the Creditors, and TDOT). As discussed above, the relationship among Mr. Thomas, the Creditors, and TDOT was contentious even prior to the commencement of this Chapter 11 case. Moreover, this severe acrimony has been carried over into this Chapter 11 case clearly impeding its success. *Compare* FED. R. BANKR. P. 1001 ("These rules shall be construed, *administered, and employed by the court and the parties* to secure the just, speedy, and inexpensive determination of every case and proceeding."). Over the course of approximately two and a half years of litigation since the filing of Mr. Thomas's Chapter 11 petition, these interested parties have filed numerous Bankruptcy Rule 7001 adversary proceedings and Bankruptcy Rule 9014 contested matters against each other, in addition to various related contested motions, and the bankruptcy court proceedings have been hampered by numerous discovery disputes among these interested parties. *See*, for example, *Petit*, 182 B.R. at 65 (affirming the appointment of a trustee due to, among others, the fact that "[t]he postpetition proceedings [were] hampered by numerous discovery disputes" and reasoning that this "may be the only way that the bankruptcy court can ensure that reorganization will proceed"). Like the above-cited cases, "this is a large messy bankruptcy that promises to get worse without a disinterested administrator at the helm." *Marvel Entm't*, 140 F.3d at 473 (citing *Cajun Elec.*, 74 F.3d at 600 (adopting dissent at 69 F.3d at 751)). This has been an unusual, atypical Chapter 11 case to say the least.

Mr. Thomas also alleges that the Creditors have not demonstrated any change in circumstances since the filing of the First Motion to give rise to the appointment of a Chapter 11 trustee; yet, this Court must strongly disagree. For example, since the filing of the First Trustee Motion, Glankler Brown, PLLC, counsel for Mr. Thomas, has withdrawn, and Mr. Thomas indicated that he would be hiring new counsel. *See* Dkt. No. 461. Despite this indication, Mr. Thomas, not a known bankruptcy lawyer, has since chosen to act *pro se*. In addition, and after almost two and a half years, no § 1125 disclosure statement has been approved and a Chapter 11 plan has yet to be filed by Mr. Thomas, the Creditors, or TDOT notwithstanding the fact that the exclusivity period aborted back in 2017. Further, there has evidently not been any type of negotiation among Mr. Thomas, the Creditors, TDOT, and other parties in interest, and it appears likely that there will be none given the exact history of this case and

the continued legalistic bickering. *See Petit*, 182 B.R. at 70 (finding that "[t]he tangled history of the[ ] proceedings suggest[ed] that 'friction' will continue at an unacceptable level"). As such, for all of the reasons mentioned above including the lengthy and severe acrimony among the parties, this Court finds that sufficient "cause" indeed exists here to cause the appointment of a Chapter 11 trustee under 11 U.S.C. § 1104(a)(1).

Unlike § 1104(a)(1)'s mandatory provision, § 1104(a)(2) "envisions a flexible standard." *Marvel Entm't*, 74 F.3d at 474. Section 1104(a)(2) expressly provides that the court shall order for the appointment of a trustee in a Chapter 11 case if it is in the best interests of the creditors and the estate. "The flexible standards embodied in § 1104(a) are intended to accommodate two goals: (1) facilitation of the debtor's reorganization; and (2) protection of the public interest and of creditors." 7 COLLIER ON BANKRUPTCY ¶ 1104.02[3][a] (16th ed. 2016) (citing H.R. 8200, 94th Cong. § 1104 (1978)). The "interests" standard appears to be more of a balancing test; that is, whether the benefits to all interests of the estate that would come from the appointment of a chapter 11 trustee outweigh the detriment of the estate. *See In re Microwave Products of America, Inc.*, 102 B.R. 666, 675 (Bankr. W.D. Tenn. 1989). Courts have considered various factors when utilizing this balancing test, including: "(1) the trustworthiness of the debtor; (2) the debtor's past and present performance and prospect for rehabilitation; (3) whether the business community and creditors of the estate have confidence in the debtor; and (4) whether the benefits outweigh the costs." *LHC*, 497 B.R. at 293 (citations omitted). It should be noted that "[a]ppointment of a trustee under § 1104(a)(2) is within the sound discretion of the bankruptcy judge." *Id.* (citations omitted).

***9** Mrs. Thomas interestingly alleges, and Mr. Thomas joins in, that the Creditors' claims should be subordinated under the Bankruptcy Code, resulting in the Creditors apparently being left with non-pecuniary interests, and therefore giving rise to disregard their judicial liens and resulting interests for the purposes of §§ 1104(a)(2) and 1109(b). More specifically, Mrs. and Mr. Thomas argue, notwithstanding the Creditors' prepetition judicial liens arising out of final tort judgments, that the Creditors are not "parties in interest" under §§ 1104(a) and/or 1109(b), and that only those whose pecuniary interests may be adversely affected under § 1104(a)(2) may be considered. The test under § 1104(a)(2) regarding pecuniary interests only gives standing to "person with a financial stake in the bankruptcy court's order." *Morgenstern v. Revco D.S., Inc.* (*In re Revco D.S., Inc.*), 898 F.2d 498, 499 (6th Cir. 1990) (recognizing the Supreme Court's "public interest" exception to the pecuniary interest test and finding that the United States Trustee has proper standing when considering an appointment under § 1104).

This Court has already ruled that Clear Channel and Tennison Brothers have valid claims based in tort law and non-tort law. *See* Dkt. No. 525 (emphasis added). Moreover, this Court found that because the Creditors had "claims" under 11 U.S.C. § 101(5), they also had proper standing to request the appointment of a trustee under 11 U.S.C. §§ 1104(a)(1)-(2) and 1109(b). *Id.* (emphasis added). Further, this Court accentuated the point that "the amount of the claim, even if de minimus, may create standing to institute such actions." *Id.* (emphasis added). Therefore, the Court strongly disagrees with the arguments made by Mrs. and Mr. Thomas.

The Court notes that in this Chapter 11 case there are approximately 600 docket entries that have been made on the Court's docket sheet in the main case, five adversary proceedings, [8] and many Rule 9014 contested matters that have been made. However, very little time seems to have been devoted by Mr. Thomas to a 11 U.S.C. § 1125 disclosure statement and 11 U.S.C. § 1121 plan. Instead, so much time has been utilized by Mr. Thomas (debtor in possession) and certain interested parties, on traditional litigation matters and not core bankruptcy matters. Moreover, much time, as noted, has been unfortunately devoted to legalistic bickering. *See, e.g.*, *In re The Bible Speaks*, 74 B.R. 511 (1987) (holding that legalistic bickering between the debtor and creditors provided justification for the appointment of a chapter 11 trustee) (emphasis added).

It also is noted that a Chapter 11 trustee is a disinterested party who serves as a fiduciary. Section 1104(d) of the Bankruptcy Code requires, in part, that the Chapter 11 trustee be a "disinterested person." *See* 11 U.S.C. § 1104(d). The Bankruptcy Code defines "disinterested person" as a person that:

> (A) is not a creditor, an equity security holder, or an insider; (B) is not and was not within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

11 U.S.C. § 101(14). Here, neither Mr. Thomas nor Clear Channel, Tennison Brothers, or TDOT are disinterested parties. These immediate, non-disinterested parties have been litigating for almost fifteen years with no end in sight. A change is desperately needed in this case and estate administration and is clearly warranted.

A Chapter 11 trustee will provide an objective, dispassionate, and disinterested view, for example, on Mr. Thomas's objections to claims in addition to all the other pending and future contested matters and adversary proceedings. "The need for a neutral party to mediate disputes between the debtor and its creditors is ground for a trustee's appointment." *In re The Bible Speaks*, 74 B.R. 511, 513 (Bankr. D. Mass. 1987) (citing *In re Bonded Mailings, Inc.*, 20 B.R. 781 (E.D.N.Y. 1982). In addition, "[w]hen significant tensions are present among the parties ..., appointment of a trustee may diffuse tensions ...." 7 COLLIER ON BANKRUPTCY ¶ 1104.02[3][d] (16th ed. 2016). Moreover, in these types of situations, the appointment of a trustee may be essential to achieve successful plan negotiations and, ultimately, the reorganization of the debtor. *Marvel Entm't*, 140 F.3d at 475. Mrs. Thomas alleged that she is preparing to file a confirmable creditor Chapter 11 plan, but one has yet to be filed. In addition, Mr. Thomas argued that the Creditors, including TDOT, could file their own plan of reorganization, but have failed to do so; however, Mr. Thomas, himself, has apparently not even made an effort to do so. A Chapter 11 trustee, of course, could file a plan (and also act as a de facto mediator of sorts). Considering the high level of acrimony that exists here and the amount of legalistic bickering that has taken place among the parties certainly makes the appointment of a trustee in the best interests of all parties and the estate. *See Petit*, 182 B.R. at 70 (finding for appointment of a trustee and stating that "[w]hile some degree of antagonism and animosity between a debtor and creditors can be expected in any bankruptcy proceeding, it [can] reach[ ] a particular intensity [ ] which [can] complicat[e] efforts to 'reorganize'....); *see also The Bible Speaks*, 74 B.R. at 512 (stating that "friction [had] developed between the Debtor and the Creditors' Committee which threaten[ed] to engulf [the] estate in costly and legalistic bickering over the entire range of the reorganization process"). Therefore, under 11 U.S.C. § 1104(a)(2), this Court finds that the appointment of a Chapter 11 trustee is clearly called for and is otherwise in the best interests of the creditors and the estate in this case – i.e., a trustee with full statutory powers, duties, and responsibilities.

CONCLUSIONS

***10** Based on the totality of the particular facts and circumstances and applicable law as discussed above, this Court concludes that statutory grounds exist under both 11 U.S.C. § 1104(a)(1) and (2) for the appointment of a disinterested Chapter 11 trustee. More specifically, this Court finds that proper "cause" exists for the appointment of a Chapter 11 trustee with full powers, duties, and responsibilities and that the appointment is in the interest of the creditors as well as other interests in the estate, including Mr. and Mrs. Thomas. Thus, Clear Channel's Renewed Motion for the appointment of a Chapter 11 trustee, which has been joined by TDOT and Tennison Brothers, is hereby granted under both 11 U.S.C. § 1104(a)(1) and (2), consistent with the above findings of fact and conclusions of law.

Accordingly, based on the foregoing and consideration of the entire Chapter 11 case and its prepetition and postpetition records as a whole, **IT IS ORDERED AND NOTICE IS HEREBY GIVEN** that:

1. "Clear Channel Outdoor Inc.'s Renewed Motion for Appointment of Chapter 11 Trustee" is GRANTED and the Chapter 11 trustee to be selected and appointed by the United States Trustee for Region 8 shall serve with full statutory duties, powers, and responsibilities. [9]

2. The Bankruptcy Court Clerk shall cause a copy of this Order and Notice to be sent to the following interested persons:

William H. Thomas, Jr., *Pro Se*

13599 Perdido Key Drive, Unit T-SH2A

Pensacola, Florida 32507-4644

Debtor in Possession

Robert L. J. Spence, Jr., Esq.

Kristina A. Woo, Esq.

The Spence Law Firm

80 Monroe Avenue, Garden Suite One

Memphis, Tennessee 38103

Attorneys for Clear Channel Outdoor, Inc.

Kathy Baker Tennison, Esq.

8295 Tournament Drive, Suite 150

Memphis, Tennessee 38125

Attorney for Tennison Brothers, Inc.

Stuart B. Breakstone, Esq.

1661 International Place Drive, Suite 400

Memphis, Tennessee 38120

Attorney for Tennison Brothers, Inc.

Michael B. Willey, Esq.

Stuart F. Wilson-Patton, Esq.

Lorrie N. Hayes, Esq.

Office of the Attorney General

State of Tennessee

P.O. Box 20207

Nashville, Tennessee 37202

Attorneys for Tennessee Department of Transportation

Adam M. Langley, Esq.

Butler Snow, LLP

P.O. Box 171443

Memphis, Tennessee 38187

Attorney for Lynn Schadt Thomas

S. Keenan Carter, Esq.

Butler Snow, LLP

6075 Poplar Avenue, Suite 500

Memphis, Tennessee 38119

Attorney for Lynn Schadt Thomas

Paul A. Randolph, Esq.

Acting United States Trustee for Region 8

200 Jefferson Avenue, Suite 400

Memphis, Tennessee 38103

Sean M. Haynes, Esq.

Assistant United States Trustee for Region 8

200 Jefferson Avenue, Suite 400

Memphis, Tennessee 38103

Barbara M. Zoccola, Esq.

Assistant United States Attorney

167 N. Main, Suite 800

Memphis, Tennessee 38103

Attorney for Internal Revenue Service

John J. Cook, Esq.

Kelly L. Hagy, Esq.

Walk Cook & Lakey, PLC

431 S. Main Street, Suite 300

Memphis, Tennessee 38103

Attorneys for City of Memphis

All Citations

Slip Copy, 2019 WL 268578, 66 Bankr.Ct.Dec. 191

Footnotes

1 Clear Channel subsequently orally modified the relief sought at a pre-trial conference held on December 18, 2018, and reiterated its modified position at this Court's hearing on the Motion held on January 15, 2019. Clear Channel now seeks the appointment of a Chapter 11 trustee with full authority and powers as allotted by the Bankruptcy Code.

2 For the purposes of this Memorandum and Order, Clear Channel and Tennison Brothers will be collectively referred to as the "Creditors" and TDOT will remain separate and distinct.

3 *See* Dkt. No. 58 in Adv. Proc. No. 16-00260-K and Dkt. No. 52 in Adv. Proc. No. 16-00261-K.

4 TENN. COMP. R. & REGS. 1680-02-03-.03(1)(a)(4)(i)(I) provided that "no two structures shall be spaced less than 1,000 feet apart on the same side of the highway."

5 *See also, e.g.*, *United States v. Bond*, 762 F.3d 255, 260 n.4 (2d Cir. 2014); *Byrd v. Johnson* (*In re Byrd*), 484 Fed. Appx. 845 (4th Cir. 2012); *United States Mineral Prods. Co. v. Official Comm. of Asbestos Bodily Injury & Prop. Damage Claimants* (*In re United States Mineral Prods. Co.*), 105 Fed. Appx. 428, 430-31 (3d Cir. 2004); *Fukutomi v. United States Trustee* (*In re Bibo, Inc.*), 76 F.3d 256, 258 (9th Cir. 1996); *Keven A. McKenna, P.C. v. Official Comm. of Unsecured Creditors* (*In re Keven A. McKenna, P.C.*), 2011 WL 2214763, at *4 (D.R.I. May 31, 2011); *Allen v. King*, 461 B.R. 709 (D. Mass. 2011); *Ngan Gung Rest. v. Official Comm. Of Unsecured Creditors* (*In re Ngan Gung Rest.*), 195 B.R. 593 (S.D.N.Y. 1996); *In re Lynnhill Condo.*, 2014 WL 4629097 (Bankr. D. Md. Sept. 12, 2014); *In re Mother Hubbard, Inc.*, 152 B.R. 189 (Bankr. W.D. Mich. 1993).

6 Section 105(a) of the Bankruptcy Code provides that "[n]o provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, *sua sponte*, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules or to prevent an abuse of process." 11 U.S.C. § 105(a) (emphasis added).

7 It should be noted that the Sixth Circuit has not determined the appropriate burden of proof for the appointment of a trustee under 11 U.S.C. § 1104; and there is a circuit split as to the applicable standard. The majority view, and the one followed by two bankruptcy courts within the Sixth Circuit, is that the moving party must establish the grounds for appointment of a trustee by clear and convincing evidence. *Adams v. Marwil* (*In re Bayou Grp., LLC*), 564 F.3d 541, 546 (2d Cir. 2009); *Official Comm. of Asbestos Claimants v. G-I Holdings, Inc.* (*In re G-I Holdings, Inc.*), 385 F.3d 313 (3d Cir. 2004); *In re Sharon Steel Corp.*, 871 F.2d 1217, 1226 (3d Cir. 1989) (citation omitted); *Kwitchurbeliakin, LLC v. LaPorte Sav. Bank*, 2011 WL 93714, at *5-6 (N.D. Ind. Jan. 10, 2011); *In re Ashley River Consulting, LLC*, 2015 WL 1540941, at *9 (Bankr. S.D.N.Y. March 31, 2015); *In re Biolitec*, 2013 WL 1352302, at *8 (Bankr. D.N.J. April 3, 2013); *In re Microwave Prods. of America, Inc.*, 102 B.R. 666 (Bankr. W.D. Tenn. 1989); *In re William A. Smith Constr. Co.*, 77 B.R. 124 (Bankr. N.D. Ohio 1987); *In re St. Louis Globe-Democrat, Inc.*, 63 B.R. 131 (Bankr. E.D. Mo. 1985); *In re Evans*, 48 B.R. 46 (Bankr. W.D. Tex. 1985). However, the minority of courts believe that the moving party should establish the grounds for appointment of a trustee a preponderance of the evidence. *Keeley & Grabanski Land P'ship v. Keeley* (*In re Keeley & Grabanski Land P'ship*), 455 B.R. 153 (B.A.P. 8th Cir. 2011); *In re Costa Bonita Beach Resort*, 479 B.R. 14, 44 (Bankr. D.P.R. 2012); *In re Veblen West Diary LLP*, 434 B.R. 550 (Bankr. D.S.D. 2010); *Tradex Corp. v. Morse*, 339 B.R. 823 (D. Mass. 2006). The Bankruptcy Code is silent on the issue.

8 *See* Adv. Proc. Nos. 16-00260, 16-00261, 17-00157, 17-00158, and 18-00131.

9 The United States Trustee requested, at the hearing on this Motion, to withdraw its "Motion to Dismiss or, in the Alternative, Convert Chapter 11 Case to Case Under Chapter 7" if the Court decided to appoint a Chapter 11 trustee. The Court will await the submission of the United States Trustee's proposed order authorizing it to withdraw its earlier motion to dismiss or convert this case from Chapter 11 to Chapter 7.

595 B.R. 272
United States Bankruptcy Appellate
Panel of the Eighth Circuit.

IN RE: Jeannette Elaine CURRAN, Debtor.
Jeannette Elaine Curran, Debtor–Appellant,
v.
Fred Charles Moon, Trustee-Appellee

No. 18-6029
|
Submitted: January 3, 2019
|
Filed: January 25, 2019

Synopsis

Background: Chapter 7 debtor moved for relief from earlier order that indefinitely extended deadline for payment of last two installments of her bankruptcy filing fee. The United States Bankruptcy Court for the Western District of Missouri, Cynthia A. Norton, Chief Judge, 2018 WL 3816762, denied motion, and debtor appealed.

The Bankruptcy Appellate Panel, Shodeen, J., held that bankruptcy court did not abuse its discretion in denying motion for relief from earlier order that indefinitely extended deadline for payment of last two installments of Chapter 7 debtor's filing fee.

Affirmed.

***273** Appeal from United States Bankruptcy Court for the Western District of Missouri

Attorneys and Law Firms

Jeannette Elaine Curran, West Plains, MO, pro se.

Fred C. Moon, Springfield, MO, pro se.

Lee J. Viorel, III, Lowther & Johnson, Springfield, MO, for Trustee-Appellee.

Before SCHERMER, SHODEEN and SANBERG, Bankruptcy Judges.

Opinion

SHODEEN, Bankruptcy Judge,

The Debtor, Jeannette Curran, appeals the Bankruptcy Court's [1] denial of her Motion to Reconsider the Order entered which indefinitely extended the deadlines for payment of the last two installments of her filing fee. For the reasons that follow, we affirm.

FACTUAL BACKGROUND

Curran filed a voluntary chapter 7 petition simultaneously with an application to waive the filing fee. Her application was denied, and she was ordered to pay four equal installments on specific dates between April and July 2018. After conducting the 341 meeting the Chapter 7 Trustee filed objections to Curran's exemption claims and an adversary proceeding to recover real estate she transferred pre-petition. Curran amended her schedules and objections to those amendments were lodged by the Trustee. His objections to exemptions were sustained and sanctions were imposed against Curran. She then moved to voluntarily dismiss her bankruptcy case which was denied as well as her motion to reconsider that ruling.

Two installment payments were timely made by Curran. When the third installment payment was not received a standard order was entered to show cause why the case should not be dismissed. The Trustee filed a response requesting that automatic dismissal of the case for non-payment of the filing fee be denied. On June 22, 2018 the Bankruptcy Court entered an order vacating the Order to Show Cause which stated: "The Court will extend the Third and Final Installment deadlines indefinitely pending the Chapter 7 Trustee's filing of a Final Report or NDR. [2] " On July 12, 2018 Curran asked the Court to reconsider this order. Her filing was construed as a motion made under Rule 60(b). The Court denied relief and Curran appealed.

STANDARD OF REVIEW

An order denying relief under Rule 60(b) is reviewed for abuse of discretion. *Needler v. IRS (In re Burival)*, 449 B.R. 371, 377 (8th Cir. BAP 2011). An abuse of discretion

occurs when a court's judgment is based on either clearly erroneous facts or conclusions of law. *Noah v. Bond Cold Storage*, 408 F.3d 1043, 1045 (8th Cir. 2005); *Pettry v. Patriot Coal Corp.*, 511 B.R. 563, 565 (8th Cir. BAP 2014).

DISCUSSION

"An appeal from the denial of a Rule 60(b) motion does not raise the underlying ***274** judgment for our review but only the question of whether the district court abused its discretion in ruling on the Rule 60(b) motion." *Noah*, 408 F.3d at 1045 (citations omitted). Curran's request for reconsideration was filed outside of the 14 day time period for a timely appeal of the June 22, 2018 order. Consequently, the result of that order is not the subject of this appeal. Fed. R. Bank. P. 8022(a)(1); *Gey Assocs. Gen. P'ship v. 310 Assocs. (In re 310 Assocs.)*, 346 F.3d 31, 35 (2d Cir. 2003) (rule 60(b) motion is not a vehicle to assert a time barred appeal). Our review is strictly limited to the merits of Curran's Rule 60(b) motion.

Federal Rule of Civil Procedure 60(b)(1) allows a court to relieve a party from a final judgment, order or proceeding for "mistake, inadvertence, surprise, or excusable neglect." It also includes a catch-all provision that allows a court to consider granting relief where it is justified for any other reason. Fed. R. Civ. P. 60(b)(6). Rule 60(b) motions are left to the sound discretion of the court. "Rule 60(b)(1) relief will not be granted merely upon a showing of mistake. The movant must establish a meritorious defense, lack of prejudice to the plaintiff and freedom from culpability." *Forbes v. Forbes (In re Forbes)*, 218 B.R. 48, 52 (8th Cir. BAP 1998) (citations omitted). "Reversal of a district court's denial of a Rule 60(b) motion is rare because Rule 60(b) authorizes relief in only the most exceptional of cases." *In re Burival*, 449 B.R. at 377.

Curran's briefs contain extensive and repetitive factual argument expressing frustration with the bankruptcy process but she fails to identify any clearly erroneous facts or an incorrect application of the law that would entitle her to relief under any of the circumstances identified in Rule 60(b). We see no error or abuse of discretion in the Bankruptcy Court's Order denying Curran's motion for reconsideration.

Accordingly, the Bankruptcy Court's order is AFFIRMED.

All Citations

595 B.R. 272

Footnotes

1 The Honorable Cynthia A. Norton, Chief Judge, United States Bankruptcy Court for the Western District of Missouri.

2 A report that no assets are available for distribution.

909 F.3d 1256
United States Court of Appeals, Ninth Circuit.

IN RE CITY OF STOCKTON, CALIFORNIA, Debtor,
Michael A. Cobb, Objector-Appellant,
v.
City of Stockton, Debtor-Appellee.

No. 14-17269
|
Argued and Submitted November 14, 2016
|
Resubmitted December 10, 2018 San Francisco, California
|
Filed December 10, 2018

Synopsis

Background: Claimant objected to confirmation of city's proposed Chapter 9 plan. The United States Bankruptcy Court for the Eastern District of California, No. 12-32118, Christopher M. Klein, Chief Judge, entered order overruling objection and confirming plan, and claimant sought leave to appeal directly to the Court of Appeals, which was granted.

Holdings: The Court of Appeals, Thomas, Chief Judge, held that:

appeal from unstayed Chapter 9 plan confirmation order had to be dismissed as equitably moot, and

claim which originally arose out of taking of land, but which, following claimant's withdrawal of proposed compensation amount and construction of road, was limited to claim for greater compensation, could be adjusted.

Appeal dismissed.

Friedland, Circuit Judge, filed dissenting opinion.

Attorneys and Law Firms

***1258** Bradford J. Dozier (argued), Atherton & Dozier, Stockton, California, for Objector-Appellant.

Robert Loeb (argued), Orrick Herrington & Sutcliffe LLP, Washington, D.C.; Christopher J. Cariello, Orrick Herrington & Sutcliffe LLP, New York, New York; Lesley M. Durmann, Patrick B. Bocash, and Marc A. Levinson, Orrick Herrington & Sutcliffe LLP, Sacramento, California; for Debtor-Appellee.

Appeal from the United States Bankruptcy Court for the Eastern District of California, Christopher M. Klein, Chief Bankruptcy Judge, Presiding, D.C. No. 12-32118.

Before: Sidney R. Thomas, Chief Judge, and Ronald M. Gould and Michelle T. Friedland, Circuit Judges. [*]

Dissent by Judge Friedland

OPINION

THOMAS, Chief Judge:

***1259** Michael Cobb appeals the bankruptcy court's order denying his objection to confirmation of a Chapter 9. However, he did not seek a stay of confirmation at any stage; the plan has been substantially consummated; the relief of undoing plan confirmation would bear unduly on innocent third parties; and the bankruptcy court could not fashion relief without undoing the confirmed plan. Therefore, we dismiss his appeal as equitably moot. His claims also fail on the merits.

I

A

When it filed its Chapter 9 petition, Stockton became the largest city in history to seek municipal bankruptcy protection. The recession had reduced property values by half, and 22% of Stockton's residents were unemployed. *Franklin High Yield Tax-Free Income Fund v. City of Stockton* (*In re City of Stockton*), 542 B.R. 261, 265 (B.A.P. 9th Cir. 2015). The City was unable to pay bondholders, it had over-committed to public pensions, and its accounting system was in disarray. *Id.* Budget cuts left police able to respond only to emergency calls. *Id.* at 266, 274. Stockton ranked 10th in the nation in its violent crime rate, with homicides at an all-time record. *In re City*

of Stockton, 493 B.R. 772, 780 (Bankr. E.D. Cal. 2013). In a cost-cutting initiative commenced in 2008, the City workforce decreased by 25%. *Id.* The police force was reduced by 20%; the fire department's workforce by 30%; and the public works employee workforce by 38%. *Id.*

Despite these cost-cutting measures, the City projected a general fund deficit of almost $9 million as of June 2012 and a deficit of $20 to $30 million in the next fiscal year. *Id.*; *Franklin*, 542 B.R. at 266. The City Council authorized diversion of money from earmarked funds and intentionally defaulted on payments for over $2 million of bonds. *In re City of Stockton*, 493 B.R. at 781, 789. It also authorized a neutral evaluation process under California Government Code § 53760, a prerequisite to a Chapter 9 bankruptcy filing. *Franklin*, 542 B.R. at 266.

Unlike other voluntary bankruptcy petitioners, a Chapter 9 debtor must prove that it is eligible for bankruptcy relief. 11 U.S.C. §§ 109(c), 921(c). One of the statutory requirements is that the debtor must prove that it is insolvent. 11 U.S.C. § 109(c)(3). Here, the City filed a petition for an Order for Relief alleging that it was eligible for bankruptcy and, in fact, was insolvent. After a three-day bench trial, the bankruptcy court issued an extensive order making factual findings and determining that the City was eligible for Chapter 9 relief. As to insolvency, the court ***1260** examined the City's ability to: (1) pay its debts as they matured (commonly referred to as "cash insolvency"); (2) pay for the costs of providing services required for the health, safety, and welfare of the community (commonly called "service delivery insolvency"); and (3) create a balanced budget (termed "budget insolvency"). After considering the evidence, the court found that:

> The sum of the evidence establishes that the City was insolvent by all available measures when it filed its chapter 9 case. It was cash insolvent, unable to pay its debts as they came due as required by § 101(32)(C) and § 109(c)(3). That it was service delivery insolvent confirms that the cash insolvency was not a mere technical insolvency. That it was budget insolvent for the long term confirms that the insolvency would persist without realignment of revenues and expenses. Hence, the City satisfied the insolvency requirement of § 109(c)(3).

In re City of Stockton, 493 B.R. at 790–91.

The ensuing Chapter 9 proceedings were complex, costly, and contentious. *Franklin*, 542 B.R. at 266. Pre-petition settlements were reached with a number of creditors, and collective bargaining agreements were renegotiated. *Id.* Under the guidance of a court-appointed mediator, post-petition settlements were reached with the California Public Employees' Retirement System; the Stockton Police Officers' Association; the Official Committee of Retirees; Assured Guaranty Corporation (which insured the City's pension bonds); the National Public Finance Guarantee Corporation (an insurer of almost $100 million in city bonds); Ambac Assurance Corporation (an insurer of $13.3 million in City certificates of participation); and Wells Fargo Bank (indenture trustee for a number of the City's bond issues). *Id.* at 266–67. Eventually, over the objections of some creditors, including Cobb, Stockton's plan of reorganization was confirmed. *Id.* at 268.

The plan was funded by "a sales tax increase in the greatest amount and for the longest period permitted by California law." *Id.* at 271 (citation omitted). Under the plan, City employees and retirees "shared the pain" with the capital market and bond creditors, losing the pension and lifetime health benefits around which they had planned their futures. *Id.* (citation omitted). The plan provided for payment of $1.5 billion in claims distributed among 20 classes of creditors.

The plan became effective in February 2015. *Id.* at 276. Pursuant to the plan, the City made wire transfers totaling $13.1 million, including a settlement of health care benefits to retirees and payments to institutional creditors. The City implemented the provisions of the plan, restructuring its obligations to two other major institutional creditors by conveying title to 17 parking lots and garages, assigning leasehold interests, and assigning an option for the purchase of a city office building. The City has continued to make its payments pursuant to the plan, with secured creditors receiving lower payments on the secured debt and unsecured creditors receiving lesser amounts.

B

So, what was Objector-Appellant Michael Cobb's part in all of this? The background is somewhat procedurally complex. Cobb's father, Andrew Cobb, owned a parcel of land in Stockton. In 1998, the Stockton City Council resolved that the public necessity required the condemnation of a strip of land across the parcel for the purpose of building a road.

In California, the power of eminent domain can be exercised through traditional ***1261** condemnation proceedings, where possession is taken at the time of judgment, or through "quick-take" condemnation where a locality can take possession upon depositing a probable compensation amount determined by a qualified expert appraiser. Cal. Const. art. I, § 19; Cal. Civ. Proc. Code § 1255.010; *see also Mt. San Jacinto Cmty. Coll. Dist. v. Superior Court of Riverside Cty.*, 40 Cal.4th 648, 54 Cal.Rptr.3d 752, 151 P.3d 1166, 1168 (2007). Following the deposit of funds under the "quick-take" procedure, the government may move the court for an immediate possession order. Cal. Civ. Proc. Code § 1255.410. If the defendant elects to withdraw the proposed compensation amount, he waives all claims and defenses to the condemnation, except a claim for greater compensation. Cal. Civ. Proc. Code § 1255.260.

Stockton elected to use the "quick-take" process. Thus, pursuant to California Civil Procedure Code § 1255.010, the City had an expert appraise the parcel to determine the amount of just compensation owed to Andrew Cobb. The appraiser valued the parcel at $90,200.00. As required by the "quick-take" provisions, the City deposited that sum with the California State Treasurer Condemnation Deposits Fund. That same day, the City initiated eminent domain proceedings in the Superior Court of California, County of San Joaquin, to acquire a permanent easement over the parcel (the "eminent domain action").

Later that year, the Superior Court determined the City had met the requirements of § 1255.010, concluded it had met the requirements of probable compensation, and issued an Order for Prejudgment Possession in favor of the City. A road was then built on the parcel, and the Stockton City Council passed a resolution in 2000 accepting the improvements.

In the meantime, Andrew Cobb passed away and his son, Michael Cobb, inherited the parcel. After Andrew Cobb's death, Cobb was substituted in the condemnation action. He entered into a stipulation with the City allowing him to withdraw the deposited amount and, in 2000, he withdrew the entire amount of the deposit. At that point, by operation of law, he waived all of his defenses and claims to the property, except a claim for greater compensation. Cal. Civ. Proc. Code § 1255.260. In other words, Cobb gave up all rights to the property. He did not assert a counterclaim for greater compensation in the condemnation proceeding.

Seven years later, Cobb attempted to return the $90,200.00 to the City—apparently in an attempt to revoke his earlier waiver—but the City would not accept the funds, explaining that the withdrawal of probable compensation was final under California law. Cobb deposited the funds into an interest-bearing trust account.

In 2007, the Superior Court dismissed the City's eminent domain action because it had not been brought to trial within five years of its commencement, as is required by California Civil Procedure Code § 583.310. A year later, Cobb filed a complaint in San Joaquin County Superior Court, seeking relief for inverse condemnation (the "inverse condemnation action"). The complaint alleged that because the City failed to prosecute the eminent domain action, the true market value of the parcel remained undetermined and thus Cobb had not received the just compensation due him under the California Constitution. Over the next several months, Cobb amended his complaint three times, adding claims for quiet title, ejectment, trespass, and declaratory relief. The City demurred to all the amended complaints. The Superior Court sustained the City's demurrer as to the inverse condemnation claim on the ***1262** grounds that it was barred by the statute of limitations because the taking occurred more than five years before the complaint was filed, and it sustained the City's demurrer as to the other claims on the grounds that they were barred by the doctrine of intervening public use.

Cobb appealed the Superior Court's dismissal of his inverse condemnation claim solely on statute of limitations grounds. He did not appeal the dismissal of the quiet title, ejectment, trespass, or declaratory relief claims. In 2011, the Court of Appeals reversed

the dismissal of Cobb's inverse condemnation claim, finding that his claim was timely because it "did not accrue until the City's occupation of the property became wrongful, which did not occur until the eminent domain proceeding was dismissed." Thus, what remained of his state court action was simply an unliquidated and unsecured monetary damage claim. The merits of his inverse condemnation claim remain unadjudicated and unproven. As the bankruptcy court pointed out, given the various defenses available to the City, "Mr. Cobb has a very steep hill to climb in his action for greater compensation in the California courts."

Thereafter, in 2012, the City petitioned for bankruptcy protection under Chapter 9. In a Chapter 9 bankruptcy, the debtor is not required to file schedules and a statement of financial affairs. Rather, the debtor is required to file a list of creditors. 11 U.S.C. § 924. Any claim on the debtor's list is deemed filed as a proof of claim pursuant to 11 U.S.C. § 501, unless the debt is listed as contingent, disputed or unliquidated. 11 U.S.C. § 925.

When it filed its list of creditors in this case, the City identified Cobb's claim as an unsecured, disputed liability claim of an unknown amount. Subsequently, Cobb filed a proof of claim for $4,200,997.26. Cobb's claim consisted of a principal of $1,540,000.00 for the parcel, $2,282,997.26 in interest on the principal, $350,000.00 in attorney's fees and expenses, $13,000.00 in costs of suit, and $15,000.00 in real estate taxes and maintenance and insurance costs. Cobb did not assert on his proof of claim that his claim was secured.

In 2013, the City filed its first amended plan for adjustment of its debts (the "plan"), which listed 19 classes of claims. The plan included Cobb's claim in Class 12 as a general unsecured claim. On February 11, 2014, Cobb filed an objection to confirmation of the plan, alleging that his "claims in inverse condemnation are protected by the Fifth and Fourteenth Amendments to the United States Constitution and cannot be impaired by the Plan." He did not contest the listing of his claim as unsecured.

In 2014, the bankruptcy judge overruled Cobb's objection to confirmation of the pending plan of adjustment. The bankruptcy judge explained that Cobb is left with only a claim for more money because the road had long since been built on the parcel and because by withdrawing the probable just compensation, Cobb had waived by operation of law all claims except a claim for greater compensation. In an oral ruling, the bankruptcy judge concluded that "[t]he bankruptcy clause does permit the adjustment of a debt for greater compensation," and "if [the debt] were reduced to judgment, it would be a general unsecured debt at the moment the judgment was issued."

Cobb did not seek a stay of plan confirmation from the bankruptcy court. Cobb timely appealed the bankruptcy court's order overruling his objection to the plan to the district court for the Eastern District of California. He did not seek a stay of plan confirmation before the district court.

***1263** Cobb and the City both stipulated, pursuant to 28 U.S.C. § 158(d)(2)(A), that the appeal warranted proceeding directly to the Court of Appeals for the Ninth Circuit. On August 7, 2014, the district court certified this appeal to this Court, pursuant to 28 U.S.C. § 158(d)(2)(B)(ii). A motions panel of our Court granted Cobb's motion to appeal directly to this Court. Cobb did not seek a stay of plan confirmation. The bankruptcy court confirmed the City's plan of adjustment and issued a final judgment. Cobb did not seek a stay following plan confirmation, and the plan became effective on February 25, 2015.

II

A

Finality is essential to the success of bankruptcy reorganization plans. A reorganization plan almost always involves tradeoffs, debt adjustment, partial asset liquidation, and the infusion of new revenue sources. Both creditors and the debtor require certainty so that the debtor can return to economic health, and the creditors can maximize their recovery within the debtor's ability to pay. In the case of a municipal reorganization, the public has an enormous stake in the outcome so that critical government programs, such as law enforcement, fire protection, and public works, can be restored. Thus, if a creditor wishes to challenge a reorganization plan on appeal, we require the creditor to seek a stay of proceedings before the bankruptcy court. When a stay is requested, all affected parties are on notice that the plan may be subject to appellate review and have an opportunity to present evidence before the bankruptcy court of the consequences of a stay. "A confirmed

reorganization plan operates as a final judgment with *res judicata* effect." *Unsecured Creditors Comm. v. Southmark Corp.* (*In re Robert L. Helms Constr. & Dev. Co.*), 139 F.3d 702, 704 (9th Cir. 1998) (en banc).

If the creditor does not seek a stay, then the creditor risks dismissal of the appeal on the grounds of equitable mootness. "An appeal is equitably moot if the case presents transactions that are so complex or difficult to unwind that debtors, creditors, and third parties are entitled to rely on the final bankruptcy court order." *JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Props., Inc.* (*In re Transwest Resort Props., Inc.*), 801 F.3d 1161, 1167 (9th Cir. 2015) (quoting *Rev Op Grp. v. ML Manager LLC* (*In re Mortgs. Ltd.*), 771 F.3d 1211, 1215 (9th Cir. 2014)). If there is a confirmed bankruptcy plan that deserves finality—for employees, retirees, creditors, taxpayers, and for the future of the City—it is Stockton's.

B

We have identified four factors to determine whether an appeal is equitably moot, namely: (1) whether a stay was sought; (2) whether the plan has been substantially consummated; (3) the effect of the remedy on third parties not before the court; and (4) "whether the bankruptcy court can fashion effective and equitable relief without completely knocking the props out from under the plan and thereby creating an uncontrollable situation for the bankruptcy court." *In re Transwest Resort Props., Inc.*, 801 F.3d at 1167–68 (quoting *Motor Vehicle Cas. Co. v. Thorpe Insulation Co.* (*In re Thorpe Insulation Co.*), 677 F.3d 869, 881 (9th Cir. 2012)).

1

As to the first factor, there is no doubt. Cobb sought no stay whatsoever. He did not seek a stay in the bankruptcy court. He did not seek a stay in the district court. He did not seek a stay in our Court. ***1264** While he was appealing the rejection of his plan objections, he took no action to stay the plan's implementation, although confirmation proceedings were ongoing. He did nothing.

It is "obligatory" that one seeking relief from plan confirmation "pursue with diligence all available remedies to obtain a stay of execution of the objectionable order." *Trone v. Roberts Farms, Inc.* (*In re Roberts Farms, Inc.*), 652 F.2d 793, 798 (9th Cir. 1981). Failure to do so without adequate explanation should result in dismissal. *Id.* Seeking a stay affords the bankruptcy court the opportunity to consider equitable factors, make a reasoned decision, and provide a decision and record which an appellate court can review. On the other hand, excusing a failure to seek a stay before the bankruptcy court allows a party to play possum, without consequence, while everyone else has materially changed positions in reliance on plan confirmation. The first factor indisputably favors application of equitable mootness. [1]

2

The second factor is whether the plan has been substantially consummated, and Cobb does not contest the fact that it was. As the Bankruptcy Appellate Panel noted, there is no dispute that this plan was substantially consummated in February 2015. *Franklin*, 542 B.R. at 276. The City wired payment to institutional creditors, transferred property, and sent checks to former city employees to resolve pension claims. *Id.* It conveyed title to numerous parcels of real property, assigned leasehold interests, and granted purchase options. The City has now operated under the reorganization plan for years. The second factor also favors application of equitable mootness.

3

The third factor is "whether the relief sought would bear unduly on innocent third parties." *In re Transwest Resort Props., Inc.*, 801 F.3d at 1169. In other words, it must be "possible to [alter the plan] in a way that does not affect third party interests to such an extent that the change is inequitable." *Id.* (quoting *In re Thorpe Insulation Co.*, 677 F.3d at 882) (alteration in original).

Here, reversal of the Confirmation Order would undermine the settlements negotiated with the unions, pension plan participants and retirees, bond creditors, and capital market creditors, all of which were built into the reorganization plan. As the Bankruptcy Appellate Panel concluded in *Franklin*, "[t]o reverse the Confirmation Order at this point would have a potentially devastating

impact on creditor constituencies whose settlements with the City were incorporated in the Plan and who are not appearing before us in this appeal." *Franklin*, 542 B.R. at 278.

In addition to the creditors, reversal of the Confirmation Order would have a substantial effect on the citizens of Stockton, who depend upon the City for the provision of vital services. The City placed ample evidence in the record of the serious impact of reversal of plan confirmation, which impact is confirmed in *Franklin*.

Cobb argues that his claim is only a monetary one, having little impact on creditors or the City. Leaving aside the fact that the remedy he seeks is to reverse plan confirmation, Cobb is making a multi-million dollar claim which, on its face, ***1265** would have a considerable impact on the City. He suggests, without proof, that the City has the resources to pay the claim. However, as the City pointed out in *Franklin*, allowing such a claim would likely result in revisiting the City's Long Range Financial Plan, which provided the basis for the plan's feasibility, and "consequently calling into question the economic underpinnings of the Plan." 542 B.R. at 276 (internal quotation marks and citation omitted).

In addition, and most importantly, the only adjudication of the City's solvency in the record is the bankruptcy court's findings of facts and conclusions of law holding that the City was insolvent—a finding that was adopted and reiterated at the time of plan confirmation.[2] Cobb did not challenge the City's claim of insolvency in the bankruptcy court, nor dispute the bankruptcy court's findings. He simply suggests for the first time on appeal, without support in the record, that the City is not insolvent.

In sum, the third factor favors application of equitable mootness.

4

The final factor is whether the bankruptcy court could fashion equitable relief without completely undoing the plan. Of course, undoing the plan is precisely the remedy that Cobb seeks. Cobb argues that he seeks only monetary relief, but his appeal is of the bankruptcy court's order overruling Cobb's objection to confirmation of the plan of adjustment. His challenge—and his only challenge—is to the confirmation of the plan itself. In his objection to the plan before the bankruptcy court, Cobb argued that the plan could not be confirmed, and "[w]here a Chapter 9 Plan may not be confirmed, the remedy appears to be dismissal of the bankruptcy case." The Notice of Appeal was taken as to the bankruptcy court's order denying his objection to plan confirmation. On appeal, he reiterated his objection to the plan and repeated his claim that where a bankruptcy plan cannot be confirmed, the remedy is dismissal of the bankruptcy case.

Sustaining Cobb's objection would mean dismantling the confirmed reorganization plan, which is the only relief he seeks. Considering this remedy in *Franklin*, the Bankruptcy Appellate Panel concluded that "[r]eversing the Confirmation Order would 'knock the props out from under' the plan and would leave the bankruptcy court with an unmanageable situation on remand." *Franklin*, 542 B.R. at 278. The plan provides for 20 different classes of creditors, almost all of which have been deemed impaired —meaning that the legal, equitable, or contractual rights of the creditors are affected by the plan. Plan confirmation adjusted all of these rights. To reverse the Confirmation Order at this stage would create chaos and undo years of carefully negotiated settlements. The fourth factor favors application of equitable mootness.

5

Thus, as it was for the Sixth Circuit in considering a similar appeal arising out of Detroit's bankruptcy, "[t]his is not a close ***1266** call." *Ochadleus v. City of Detroit* (*In re City of Detroit*), 838 F.3d 792, 799 (6th Cir. 2016). As with the situation posed by the Detroit municipal reorganization, the complex plan has been confirmed, affecting the rights of thousands of creditors and the public.

The reorganization train has left the station. Cobb did not pursue any bankruptcy stay remedies, much less pursue them with the requisite diligence. The plan has long been substantially consummated. He offers too little, too late. None of the factors that we consider in deciding whether to apply the doctrine of equitable mootness favor Cobb. Thus, his appeal must be dismissed.

III

Cobb's underlying theory—that the Takings Clause exempts his unsecured claim from reorganization—is not viable on this record, and the bankruptcy court properly concluded that this claim fails on the merits. The Takings Clause is only implicated in bankruptcy if the creditor has actual property rights. In other words, the creditor must have an "*in rem* right under nonbankruptcy law to look to specific items of property" in order for the debt to be paid ahead of unsecured creditors. 4 *Collier on Bankruptcy* ¶ 506.03 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2017). If the purported property interest is, in reality, just a contractual or statutory right for monetary relief, then the debt can be adjusted in bankruptcy.

A

Distilled to its essence, Cobb's argument on appeal is that he has a property interest that cannot be adjusted in bankruptcy. But that is not what his bankruptcy claim is, or even what he asserted that his was. As we have noted, both the City and Cobb classified his claim as an unsecured monetary claim. Cobb has never challenged the categorization of the claim as unsecured; nor has he sought, through 11 U.S.C. § 506 or otherwise, to have his interest adjudicated otherwise. Indeed, prior state court judgments against him would have precluded that.

Even assuming that Cobb had asserted a property-based proof of claim, it failed on the merits to be categorized as such, as the bankruptcy court found. First, he had relinquished his property interest in the land more than 15 years before bankruptcy was filed. As we have noted, under California's "quick-take" condemnation proceedings, Stockton properly hired a qualified expert appraiser, who valued the property. Following the statutory procedure, Stockton then deposited the funds and moved the superior court for immediate possession of the property, and the superior court granted the City immediate possession of the parcel. Andrew Cobb did not object to the probable just compensation finding or judgment.

As we have noted, under California law, if the property owner elects to withdraw the proposed compensation amount, he waives all claims and defenses to the condemnation, except a claim for greater compensation. Cal. Civ. Proc. Code § 1255.260. Michael Cobb withdrew the deposit, thereby waiving all claims, except as to a claim for greater compensation. In other words, Cobb gave up all rights to the property. He did not assert a counterclaim for greater compensation in the condemnation proceeding.

Seven years later, he tried to return the money, which the City declined. His subsequent suit against the City, in which he sought quiet title and declaratory relief, among other remedies, was dismissed. In sum, the relief he sought to enforce property rights or restoration of his property ***1267** interest was rejected. That judgment is final and binding. He did not take an appeal from that decision, except as to the statute of limitations on his inverse condemnation claim. The California Court of Appeal granted him relief on that question. So, what remains of his state court action is simply an unliquidated and unsecured monetary damage claim.

Thus, the bankruptcy court properly concluded that once Cobb withdrew the tendered compensation, he waived by operation of law all claims and defenses in his favor as to the property, except for a claim for greater compensation, which is an unsecured monetary debt claim.

Second, Cobb independently relinquished any property interest he had by allowing the City to construct the road and open the road to public use. Under California law, if a property owner allows the government to complete the taking of the property for public use, he is "denied the right to enjoin the agency." *Frustuck v. City of Fairfax*, 212 Cal.App.2d 345, 28 Cal.Rptr. 357, 373 (1963). The fact that formal title has not passed is irrelevant under California law. *California ex rel. Dep't of Pub. Works v. Peninsula Title Guar. Co.*, 47 Cal.2d 29, 301 P.2d 1, 3 (1956) (noting that when there has been a prior physical taking the subsequent title transfer "is merely a confirmation of the original taking").

Thus, when the bankruptcy was filed, Cobb did not possess a right to the property protected by the Fifth Amendment. It had been extinguished. What remained was bare legal title—without any other property rights and subject to defeasance by the prior litigation—and an unsecured statutory monetary claim for greater compensation.

Cobb's theory seems to be that an unliquidated, statutory claim for greater compensation cannot be adjusted in bankruptcy. But it is purely a monetary claim. As the bankruptcy court pointed out, if the inverse condemnation claim had been reduced to a judgment, it would be subject to adjustment in bankruptcy; therefore, it is not logical to say that an unliquidated claim for greater compensation cannot be adjusted in bankruptcy.

Nor does the character of any claim asserting an unconstitutional taking make it immune from evaluation on the merits in bankruptcy. Indeed, we have approved the dismissal of a takings claim in its entirety by a bankruptcy court. *George v. City of Morro Bay (In re George)*, 322 F.3d 586, 590–91 (9th Cir. 2003) (per curiam). Cobb cannot implicate the Takings Clause in order to elevate his claim above other Fifth Amendment-protected property interests—which are adjustable in bankruptcy—and to escape procedural requirements. *See Bennett v. Jefferson Cty.*, 899 F.3d 1240, 1251 (11th Cir. 2018) (quoting *Henderson v. United States*, 568 U.S. 266, 271, 133 S.Ct. 1121, 185 L.Ed.2d 85 (2013)) ("[T]he mere fact that a potential or actual violation of a constitutional right exists does not generally excuse a party's failure to comply with procedural rules for assertion of the right. A 'constitutional right, or a right of any other sort, may be forfeited in criminal as well as civil cases by the failure to make timely assertion of the right before a tribunal having jurisdiction to determine it.' ").

Cobb had ample opportunities in the bankruptcy court to adjudicate the nature of his claim through a variety of procedural mechanisms. He did not do so. He listed his claim as unsecured and did not file any proceeding to have the court determine its secured status. He did not object to the disclosure statement. He did not seek exemption from discharge. It would be improper not only to excuse all of these ***1268** failures, but to invent for him an entirely new remedy on appeal. One cannot play possum during bankruptcy proceedings and then claim some new interest after a plan has been confirmed. A contrary holding would emasculate bankruptcy proceedings.

B

Cobb argues that his monetary claim has protected status because it was originally founded as a constitutional claim. However, other constitutionally based lawsuits seeking money damages, such as § 1983 claims, are routinely adjusted in bankruptcy—and, in fact, were adjusted in this bankruptcy. Cobb cites *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 55 S.Ct. 854, 79 L.Ed. 1593 (1935), for the unremarkable proposition that the bankruptcy power is subject to the Fifth Amendment. However, that "does not mean, of course, that secured creditors are immune from the bankruptcy process." 4 *Collier on Bankruptcy* ¶ 506.02. Rather, "in a number of contexts the Code expressly permits the adjustment of debts of secured creditors, including lien rights." *Id.*

Moreover, as the Supreme Court itself suggested in *Helvering v. Griffiths*, 318 U.S. 371, 400–01 & n.52, 63 S.Ct. 636, 87 L.Ed. 843 (1943), the precedential weight of *Radford* is uncertain in light of *Wright v. Vinton Branch*, 300 U.S. 440, 57 S.Ct. 556, 81 L.Ed. 736 (1937), in which the Court upheld the same act struck down in *Radford* following relatively minor amendment. Indeed, the relevant problem addressed in *Radford* is "the taking of substantive rights in specific property acquired by the bank *prior* to the act." *Radford*, 295 U.S. at 590, 55 S.Ct. 854 (emphasis added). This reading of *Radford* presents an easy synthesis with *United States v. Security Industrial Bank*, in which the Court held that constitutional infirmity could be avoided by reading a bankruptcy statute as not compromising security interests created before the statute was enacted. 459 U.S. 70, 81, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982). The Supreme Court has never held that the Takings Clause renders claims that accrued after the Bankruptcy Code was enacted immune from the Bankruptcy power, or the bankruptcy process. [3] In short, *Radford* does not reach as far as Cobb asserts.

Further, "just compensation" under the Takings Clause is not equivalent to "full compensation." *United States v. Norwood*, 602 F.3d 830, 834 (7th Cir. 2010). The concept of "just compensation" requires consideration of "all circumstances," including whether the contemplated compensation "would result in manifest injustice to owner or public." *United States v. Commodities Trading Corp*, 339 U.S. 121, 123, 70 S.Ct. 547, 94 L.Ed. 707 (1950) ("[T]he dominant consideration always remains the same: What compensation is 'just' both to an owner whose property is taken and to the public that must pay the bill?").

In sum, when Stockton filed its bankruptcy petition, Cobb did not possess a property interest cognizable as

such in bankruptcy, and he never asserted anything but an unsecured proof of claim. His unsecured claim for greater compensation was not tethered to the actual property interest he had when the bankruptcy was filed. Rather, his claim is for the purported rights that were extinguished long before ***1269** the bankruptcy was filed. What he is left with after bankruptcy is bare property title and an unliquidated unsecured claim. Given the circumstances of the case, the bankruptcy court correctly determined that Cobb's claim was properly categorized in the reorganization plan and properly overruled his objection to plan confirmation.

IV

Stockton's reorganization plan was confirmed and has been substantially consummated. Undoing the confirmed plan would seriously affect the rights of third parties. Cobb did not take the minimal step of seeking a stay at any level—not before the bankruptcy court, not before the district court, and not before us. On the merits, the bankruptcy court properly rejected his claim. The claim was correctly categorized as unsecured and adjusted as such.

This appeal is not the first time that the question of equitable mootness has arisen in the context of this bankruptcy. In *Franklin*, the Bankruptcy Appellate Panel carefully reviewed the challenge of a large capital market creditor to Stockton's plan of reorganization. It concluded that the creditor's challenge was equitably moot in consideration of the substantial consummation of the plan, the effect on third parties, and whether relief could be fashioned without destroying the plan. *Franklin*, 542 B.R. at 264–65. The same considerations apply here, with the same effect.

DISMISSED.

FRIEDLAND, Circuit Judge, dissenting:

The Bill of Rights constrains the powers given to Congress by Article I of the Constitution. And, in particular, the Fifth Amendment's requirement that the government provide just compensation for any taking of private property constrains the powers granted to Congress by the Bankruptcy Clause of Article I. Takings claims should therefore be excepted from discharge in bankruptcy.

The majority contends that the judge-made bankruptcy doctrine of equitable mootness is the dominant principle at issue in this appeal, and that it prevents us from even adjudicating the constitutional claim to just compensation asserted by Appellant Michael Cobb ("Cobb") against the City of Stockton ("City"). But equitable mootness has no role to play here. Cobb seeks only to have his claim to just compensation excepted from discharge—that is, to effectively be treated as falling outside the City's bankruptcy adjustment plan ("Plan"). A claim that falls outside of bankruptcy cannot be subject to the bankruptcy doctrine of equitable mootness. I would therefore reach the merits of Cobb's appeal rather than dismissing it.

As to the merits, there is no dispute that the City condemned Cobb's property. [1] And, after that happened, Cobb took all actions necessary under state law to preserve his right to just compensation for the taking of that property. Indeed, his state court action for just compensation would ***1270** have proceeded if it had not been stayed in response to the City's bankruptcy filing. Because Cobb maintains a constitutional claim for just compensation, and because that claim should have been excepted from discharge, I would hold that Cobb's state-court inverse condemnation action should be allowed to proceed.

I.

The majority concludes that any appeal seeking to unravel the Plan would be equitably moot. Even assuming so, undoing the confirmed Plan is not on the table in this appeal. Cobb has been abundantly clear before our court that he seeks only to except his claim from discharge, and thus to remove his claim from the Plan altogether. Although Cobb originally lodged his complaint as an objection to the Plan, which may have seemed to him the only option given the novelty of the legal issue his situation presented, he has since plainly disclaimed any intent to "unwind" the Plan. Equitable mootness considerations are therefore irrelevant here and should not prevent us from adjudicating Cobb's argument that his takings claim was entitled to "pass through [the] bankruptcy unaffected." *In re Towers*, 162 F.3d 952, 953 (7th Cir. 1998).

Equitable mootness "reflects an *unwillingness* to provide relief" in cases involving bankruptcy "transactions that are so complex or difficult to unwind that debtors, creditors, and third parties are entitled to rely on the final bankruptcy court order." *In re Transwest*, 801 F.3d 1161, 1167 (9th Cir. 2015) (quoting *In re Mortgs. Ltd.*, 771 F.3d 1211, 1215 (9th Cir. 2014)). I am unaware of any case in which we have applied an equitable mootness analysis to an individual's claim that an asset should have been excepted from discharge and excluded from bankruptcy proceedings altogether. Indeed, it makes no sense to extend this judicially created doctrine to cases like this one. The sole point of this appeal is that Cobb should have been permitted to pursue his claim outside of the Plan because his claim should have been excepted from discharge. *See In re Towers*, 162 F.3d at 953. Such an appeal could never undo a plan. If an appellant like Cobb prevails, his or her claim will survive totally apart from the plan, and recognition of such survival will in no way change the terms of the plan. If the appellant does not prevail, then it will have been appropriate to have discharged his or her claim as part of the plan, and there will thus be no reason to change the terms of the plan. [2]

The majority relies on *Franklin High Yield Tax-Free Income Fund v. City of Stockton*, 542 B.R. 261, 265 (B.A.P. 9th Cir. 2015), to conclude that we should dismiss this appeal because Cobb's claim might jeopardize the City's financial health. In fact, the Bankruptcy Appellate Panel in *Franklin* recognized that a claim ***1271** solely for a monetary remedy—unlike a claim seeking to undo the Plan—would not necessitate disturbing the Plan and so would not be moot. *Id.* at 277. As a result, the Bankruptcy Appellate Panel concluded that "to the extent [the creditor] s[ought] through its appeal [from confirmation of the Plan] only a greater payment on its unsecured claim ... an effective remedy [was] theoretically possible, and that claim [was] not equitably moot." *Id.* at 278. [3] *Franklin* thus did not, as the majority suggests, hold that requiring the City to pay a monetary judgment would threaten the integrity of the Plan.

Because this appeal in no way threatens the finality of the Plan, and in fact seeks to allow Cobb's claim to proceed totally apart from the Plan, I would fulfill our "virtually unflagging obligation ... to exercise the jurisdiction given" us by ruling on the merits. *Colo. River Water Conservation Dist. v. United States*, 424 U.S. 800, 817, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976).

II.

With respect to the substance of Cobb's claim, the majority is persuaded that Cobb has waived all property rights in the condemned parcel as a matter of California law, including his right to seek just compensation. And, even if he has not, the majority appears to conclude that a claim for just compensation could be reduced in bankruptcy. I disagree on both counts. Starting with the latter point, as a matter of constitutional first principles, I believe municipalities are obligated to provide just compensation for any taking of private property, regardless of the bankruptcy laws. And regarding Cobb's claim in particular, I believe that Cobb has preserved a constitutional claim for just compensation, and that his claim thus should have been excepted from discharge. [4]

A.

"Congress, in common with all branches of the Government, must exercise its powers subject to the limitations placed by the Constitution on governmental action," including "the relevant limitations of the Bill of Rights." *Barenblatt v. United States*, 360 U.S. 109, 112, 79 S.Ct. 1081, 3 L.Ed.2d 1115 (1959). Where, for example, a statute violates the First Amendment, it is no answer that the statute was properly enacted pursuant to Congress's power under the Commerce Clause. *See Cal. Bankers Ass'n v. Shultz*, 416 U.S. 21, 77, 94 S.Ct. 1494, 39 L.Ed.2d 812 (1974) (noting that Congress "is of course subject to the strictures of the Bill of Rights, and may not transgress those strictures" when enacting legislation). Accordingly, although Congress has the authority to enact "uniform Laws on the subject of Bankruptcies," U.S. Const. art. I, § 8, cl. 4, such laws must not take away rights guaranteed by the Bill of Rights. These rights include the Fifth Amendment's proscription, operational against the states under the Fourteenth Amendment, that private property shall not "be taken for public use, without just compensation," U.S. Const. amend. V. *See* ***1272** *Dolan v. City of Tigard*, 512 U.S. 374, 383–84, 114 S.Ct. 2309, 129 L.Ed.2d 304 (1994).

In addressing the interplay between these clauses of the Constitution, the Supreme Court has confirmed that the Takings Clause of the Fifth Amendment constrains the

power conferred by the Bankruptcy Clause of Article I. The Court first discussed this principle in *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 55 S.Ct. 854, 79 L.Ed. 1593 (1935). *Radford* held that the Frazier-Lemke Act, which effectively permitted a debtor to purchase mortgaged property for less than its fair market value, was unconstitutional. The Court explained that "[t]he bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment." *Id.* at 589, 55 S.Ct. 854. As a result, the Act's impairment of a mortgagee's rights violated the Takings Clause:

> [T]he Fifth Amendment commands that, however great the Nation's need, private property shall not be ... taken even for a wholly public use without just compensation. If the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain.

Id. at 602, 55 S.Ct. 854. In short, *Radford* teaches that the Takings Clause prohibits the impairment in bankruptcy of "substantive rights in specific property," such as the rights of a mortgagee in real property. [5] *Id.* at 590, 55 S.Ct. 854.

Similarly, in the *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 95 S.Ct. 335, 42 L.Ed.2d 320 (1974), the Court expressed concern that a bankruptcy statute might unconstitutionally leave a taking uncompensated, though it concluded that a mechanism existed to provide just compensation, alleviating that concern. *Id.* at 149, 155, 95 S.Ct. 335. Those cases involved a challenge to the constitutionality of the Regional Rail Reorganization Act, under which railroad creditors would receive securities of then-unknown value to compensate them for the conveyance of the railroads' property. *Id.* at 117–18, 95 S.Ct. 335. The Court recognized that the reorganization "might raise serious constitutional questions" absent a method to challenge the amount of compensation received, because the properties were to be transferred before it was clear whether the securities would satisfy the requirement of just compensation. *Id.* at 149, 155, 95 S.Ct. 335. But because the creditors had "recourse to a Tucker Act suit in the Court of Claims for a cash award to cover any constitutional shortfall," the Court held that the reorganization provided "adequate assurance that any taking w[ould] be compensated." *Id.* at 155, 95 S.Ct. 335.

The Court subsequently reconfirmed in *United States v. Security Industrial Bank*, 459 U.S. 70, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982), that "[t]he bankruptcy power is subject to the Fifth Amendment's prohibition ***1273** against taking private property without just compensation." *Id.* at 75, 103 S.Ct. 407. There, the Court considered a Takings Clause challenge to the Bankruptcy Code exemption in 11 U.S.C. § 522(f)(2), which permits individual debtors to avoid liens on certain personal property, such as household goods or appliances, in bankruptcy proceedings. *Id.* at 71–73, 103 S.Ct. 407. Holders of non-purchase-money, non-possessory liens on such property argued that retroactive application of § 522(f) to their liens would exact a taking. *Id.* at 73, 103 S.Ct. 407. The Court agreed that retroactive application of the statute would raise serious constitutional questions, because the provision "could be read literally to divest property interests which had been created before it was enacted." *Id.* at 80, 103 S.Ct. 407. Emphasizing " 'the absence of a clear expression of Congress' intent to' apply" the provision to preexisting liens, the Court invoked the doctrine of constitutional avoidance to hold that the statute did not apply retroactively, thus averting the possibility that § 522(f) might result in a taking. *Id.* at 78–82, 103 S.Ct. 407 (quoting *NLRB v. Catholic Bishop of Chi.*, 440 U.S. 490, 507, 99 S.Ct. 1313, 59 L.Ed.2d 533 (1979)). [6]

These decisions underscore that Congress's bankruptcy powers do not allow it to infringe upon rights guaranteed by the Takings Clause. Where a taking has occurred, just compensation is owed and cannot be reduced—bankruptcy notwithstanding. Accordingly, a municipality may not nullify its obligation to pay just compensation for seized property through a chapter 9 proceeding. Rather, claims for just compensation should be excepted from discharge, such that they survive any bankruptcy intact. [7]

B.

Unlike the majority, I believe Cobb took all the steps necessary to preserve his ***1274** constitutional claim for just compensation. When Cobb's property was

condemned by the City, he obtained a constitutional right to just compensation.[8] He retained this right by filing an inverse condemnation action and pursuing it in accordance with the appropriate state procedures. That action is still pending in state court, having been stayed when the City filed its bankruptcy petition. As a result, Cobb maintains a claim for just compensation that should now be allowed to proceed.

The majority instead holds that Cobb has forfeited all property rights in the condemned parcel under California law, and that his pending claim is "simply" a statutory claim for monetary damages. But the statutory character of Cobb's claim does not diminish its constitutionally protected status—indeed, a constitutional claim for just compensation *is* a statutory claim for monetary damages under California law.

And Cobb did not forfeit his right to just compensation by either withdrawing the probable just compensation funds or permitting the public to use the road. The California Supreme Court has in fact explained that the constitutionality of the state's quick-take scheme rests in part on its allowing a continuing claim for greater compensation after deposited funds are withdrawn. *Cf. Mt. San Jacinto Cmty. Coll. Dist. v. Superior Court*, 40 Cal.4th 648, 54 Cal.Rptr.3d 752, 151 P.3d 1166, 1175 (2007). I thus disagree that Cobb has completely relinquished his interest in the property.

1.

The majority's conclusion that Cobb's inverse condemnation action somehow became untethered from the Takings Clause is both inconsistent with California law and fundamentally at odds with the Fifth Amendment. To demonstrate why this is so, it is necessary to describe the constitutional nature of Cobb's pending inverse condemnation action under California law.

Because the Fifth Amendment "proscribes takings *without just compensation*, no constitutional violation occurs until just compensation has been denied." *Williamson Cty. Reg'l Planning Comm'n v. Hamilton Bank of Johnson City*, 473 U.S. 172, 194 n.13, 105 S.Ct. 3108, 87 L.Ed.2d 126 (1985). The Fifth Amendment does not require payment of just compensation "in ***1275** advance of, or contemporaneously with, the taking; all that is required is that a 'reasonable, certain and adequate provision for obtaining compensation' exist at the time of the taking." *Id.* at 194, 105 S.Ct. 3108 (quoting *Reg'l Rail Reorg. Act Cases*, 419 U.S. at 124–25, 95 S.Ct. 335). Accordingly, "if a State provides an adequate procedure for seeking just compensation, the property owner cannot claim a violation of the Just Compensation Clause until it has used the procedure and been denied just compensation." *Id.* at 195, 105 S.Ct. 3108.

California provides such a process by making available an action for inverse condemnation. *See Regency Outdoor Advert., Inc. v. City of Los Angeles*, 39 Cal.4th 507, 46 Cal.Rptr.3d 742, 139 P.3d 119, 123 (2006) ("Inverse condemnation actions provide a vehicle for property owners to obtain 'just compensation.' "); *Adam Bros. Farming v. Cty. of Santa Barbara*, 604 F.3d 1142, 1147–48 (9th Cir. 2010) (noting that the procedure for seeking just compensation in California is an inverse condemnation action). An inverse condemnation action enables a property owner to enforce his constitutional right to just compensation, *Baker v. Burbank-Glendale-Pasadena Airport Auth.*, 39 Cal.3d 862, 218 Cal.Rptr. 293, 705 P.2d 866, 868 (1985), when a municipality "has taken private property for public use without following the requisite condemnation procedures," *Customer Co. v. City of Sacramento*, 10 Cal.4th 368, 41 Cal.Rptr.2d 658, 895 P.2d 900, 905 (1995).

An inverse condemnation action became available to Cobb when the City failed to prosecute its eminent domain action to final judgment and thus did not complete the condemnation procedures required under California law to compensate Cobb and to secure title for the City.[9] *See Redev. Agency v. Gilmore*, 38 Cal.3d 790, 214 Cal.Rptr. 904, 700 P.2d 794, 802 (1985) (explaining that title to condemned property does not pass until a final order of condemnation has been recorded, including in a quick-take case); *accord* Cal. Civ. Proc. Code § 1268.030(c). The majority misunderstands the significance under state law of Cobb's retention of title. Where, as here, a municipality takes possession of property using the quick-take process, title to the property does not vest in the municipality until there has been a jury determination of just compensation, the full amount of that compensation has ***1276** been paid, a final judgment has been entered in the eminent domain action, and a final order of condemnation has been recorded. Cal. Const. Art. 1, § 19; Cal. Civ. Proc. Code § 1268.030(a), (c). Because the City

failed to pursue its eminent domain claim to completion, no jury determination of just compensation occurred, Cobb's takings claim was never finally adjudicated, and title to his property never passed to the City. *See Redev. Agency*, 214 Cal.Rptr. 904, 700 P.2d at 802; *Prop. Reserve, Inc. v. Superior Court*, 204 Cal.Rptr.3d 770, 375 P.3d 887, 907–08 (2016) (observing that, under California law, condemnation requires "a jury determination of just compensation"). As a result, although the majority is correct that Cobb could not now eject users of the road from the land, Cobb's title is meaningful because it demonstrates that he has an outstanding constitutional claim for just compensation. *See id.*

Cobb's efforts to pursue that claim were halted when the City's bankruptcy filing led to a stay of Cobb's inverse condemnation proceeding. To this day, Cobb remains the legal owner of the property with an outstanding claim for just compensation. [10]

2.

The majority recasts Cobb's effort to enforce his constitutional right to just compensation as a mere monetary claim that is based on California's statutory scheme rather than the United States Constitution. As a preliminary matter, of course Cobb's claim takes the form of a statutory claim for money. The Fifth Amendment requires that states provide a mechanism for compensating land owners for their condemned property, so such takings claims will generally be brought in accordance with procedures laid out in state statutes. Takings claims arising in California do not somehow lose their constitutional status merely because California's procedures for seeking just compensation were codified by statute rather than solely through caselaw. And all actions for just compensation could be characterized as claims for money; that is the nature of the claim. *Cf. Lucree v. United States*, 117 Fed.Cl. 750, 752 (2014) ("A claim for just compensation [under federal law] is a claim for money damages cognizable under the Tucker Act."). [11] The fact that Cobb's claim takes the form of a statutory claim ***1277** for money damages, therefore, does not render it something other than a claim for just compensation arising out of the Fifth Amendment.

Additionally, Cobb's claim for just compensation did not lose its constitutional mooring when Cobb withdrew the probable just compensation funds. Cobb undeniably waived certain rights by withdrawing the funds, including his ability to challenge the City's "right to take" and "any claim as to lack of a public purpose." *See Clayton v. Superior Court*, 67 Cal.App.4th 28, 78 Cal.Rptr.2d 750, 752 (1998). But the plain language of California Civil Procedure Code § 1255.260 preserves Cobb's right as the owner of the property to seek "greater compensation."

And try as the majority might to reframe a claim for "greater compensation" as some monetary claim unrelated to the property owner's constitutional right to just compensation for taken property, the California Supreme Court has equated a claim for greater compensation following a quick take procedure with the constitutional right to just compensation. *See Mt. San Jacinto Cmty. Coll. Dist.*, 54 Cal.Rptr.3d 752, 151 P.3d at 1175 (rejecting a party's argument that California's quick-take procedures deprive property owners of their constitutional right to just compensation on the ground that "section 1255.260 does not require waiving a claim for greater compensation with withdrawal of the deposit"). Under California law, a claim for "greater compensation" comprises Cobb's ability "to litigate the issue of adequate compensation," *Clayton*, 78 Cal. Rptr.2d at 753, that is, the "amount of 'just compensation' to which [he] [i]s entitled," *Contra Costa Water Dist. v. Vaquero Farms, Inc.*, 58 Cal.App.4th 883, 68 Cal.Rptr.2d 272, 274–75 (1997) (rejecting the argument that a condemnee waived the ability to argue that just compensation had not yet been paid by withdrawing the probable just compensation deposit under section 1255.260). The amount of just compensation is precisely the matter at issue in Cobb's inverse condemnation action.

Nor did Cobb relinquish his interest in just compensation by, as the majority puts it, "allowing the City to construct a road and open it to public use." [12] In support of the contention that he did, the majority cites *Frustuck v. City of Fairfax*, 212 Cal.App.2d 345, 28 Cal.Rptr. 357 (1963), which held that "where a property owner permits the completion by a ... public agency of the work which results in the taking of private property for a public use he will be denied the right to enjoin the agency." *Id.* at 373. But *Frustuck* speaks to a landowner's *right to enjoin*, not his ability to seek just compensation, and thus has no applicability here. *See id.* Indeed, the very next sentence of *Frustuck* following the passage quoted by the majority states: "[The property owner's] only remedy under such

circumstances is a proceeding in inverse condemnation to recover damages." *Id.* *Frustuck* thus does not stand for the proposition that intervening public use deprives a condemnee of *all* property rights. *Frustuck* merely clarifies that, instead of injunctive relief, the appropriate remedy in such circumstances is to seek just compensation in an inverse condemnation action—the very course Cobb pursued. [13]

***1278** Accordingly, Cobb has not relinquished his right to seek just compensation under California law. Cobb's right to just compensation arose when the City seized his property for public use nearly 20 years ago, and he has adequately pursued that right ever since.

3.

Finally, the majority places great weight on Cobb's failure to contest the unsecured classification of his claim within the Plan. But the Constitution's mandate that takings claims be excepted from discharge does not depend on whether those claims were initially classified in any bankruptcy proceeding as secured or unsecured; the whole point of nondischargeability is that nondischargeable claims pass through bankruptcy unaffected, *see In re Grynberg*, 986 F.2d 367, 370 (10th Cir. 1993). And the Bankruptcy Code does not require a creditor with a claim that is excepted from discharge to file a proof of claim in the bankruptcy proceeding to preserve that claim in its entirety. *Id.* (describing how a "holder of a nondischargeable debt" is "free to pursue the debtor outside bankruptcy"); *see also In re Kolstad*, 928 F.2d 171, 174 (5th Cir. 1991) (recognizing that if a creditor with a nondischargeable claim "elected not to participate in the bankruptcy case and not to file a claim, the debtor would remain burdened by that debt following bankruptcy"). [14] Instead, the Federal Rules of Bankruptcy Procedure plainly state that a complaint seeking exception from discharge "may be filed at any time." [15] Fed. R. Bankr. P. 4007(b). As a result, the classification of Cobb's claim within the Plan is irrelevant here.

Moreover, while Cobb may not have challenged his claim's specific classification, he unequivocally maintained throughout the bankruptcy proceeding that his claim for just compensation was "protected by the Fifth and Fourteenth Amendments to the United States Constitution and c[ould not] be impaired by the Plan" or treated as a mere " 'general unsecured' claim." This line of reasoning plainly encompasses the argument that his claim should have been excepted from discharge. Cobb has now also clearly expressed to our court that the remedy he requests is to preserve his takings claim. Given that the parties had an opportunity to address all of the relevant issues, I see no reason to ***1279** fault Cobb for failing to challenge the categorization of his claim as unsecured. After all, "the bankruptcy law is not supposed to function merely as a procedural gauntlet that only the most adroit or best represented creditors can overcome." *Kolstad*, 928 F.2d at 173.

III.

Contrary to the majority's suggestions, the sky will not fall if Cobb is allowed to pursue his claim for just compensation. I am not blind to the City's herculean task of pulling itself out of bankruptcy, but a ruling for Cobb would not topple the Plan, or somehow throw the City back into bankruptcy. The City has presented no evidence that Cobb cannot be compensated for his condemned property while the City carries out its Plan. The City has not, for example, argued that it would have to claw back distributions under the Plan to pay Cobb. Indeed, the City has not even claimed that it is currently insolvent. [16] And, because Cobb seeks to proceed entirely outside of the Plan, the City would be under no obligation to compensate him within the same timeframe in which it compensates creditors under the Plan. *See supra* note 14.

In addition, as the majority itself notes, just compensation does not necessarily mean full compensation. *United States v. Norwood*, 602 F.3d 830, 834 (7th Cir. 2010). I agree with the majority that a determination of just compensation requires considering whether the compensation "would result in manifest injustice to owner or public." *United States v. Commodities Trading Corp.*, 339 U.S. 121, 123, 70 S.Ct. 547, 94 L.Ed. 707 (1950). But the analysis of what just compensation entails must take place under the Fifth Amendment, rather than through the lens of the Bankruptcy Code.

Moreover, recognizing the protected nature of Cobb's claim would have implications only for other takings claims, and thus would not leave the City vulnerable to a slew of new liabilities arising from other sorts of

constitutional claims. The import of Cobb's claim is not merely that he has a constitutional right—it is that he has a constitutional right *to just compensation*.[17] The Takings Clause stands alone among constitutional provisions in requiring a specific compensatory remedy. By contrast, nothing in the Constitution expressly guarantees compensation for a violation by a city of, for example, the Equal Protection Clause of the Fourteenth Amendment. *See* ***1280** *In re City of Detroit*, 524 B.R. 147, 265 (Bankr. E.D. Mich. 2014) (concluding that, in contrast to the Takings Clause, "the Fourteenth Amendment does not provide a substantive constitutional right to compensation for damages"). The majority's observation that other constitutional claims are routinely reduced during bankruptcy proceedings misses this crucial distinction.

IV.

For the foregoing reasons, I respectfully but adamantly dissent.

All Citations

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Footnotes

* This case was originally submitted to a panel that included Judge Kozinski. After Judge Kozinski's retirement, Judge Gould was drawn by lot to replace him. Ninth Circuit General Order 3.2.h. Judge Gould has read the briefs, reviewed the record, and listened to oral argument.

1 In *Franklin*, in which the Bankruptcy Appellate Panel dismissed an appeal in this bankruptcy as equitably moot, the creditor had a much better argument than Cobb because it had actually sought a stay in bankruptcy court. *Franklin*, 542 B.R. at 275.

2 Further, even if Cobb could demonstrate the City's ability to fund the claim, the solvent-debtor exception to the stay requirement does not apply where, as here, there has "been such a comprehensive change in circumstances as to render it inequitable for the court to consider the merits of the appeal." *Platinum Capital, Inc. v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.)*, 314 F.3d 1070, 1074 (9th Cir. 2002). This rule makes good sense, as "[b]ankruptcy cases often implicate parties besides the debtor and its creditors." *In re Mortgs. Ltd.*, 771 F.3d at 1216.

3 *See, e.g.*, James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 974 (1983).

1 I note that the fee owner of the parcel is the Andrew C. Cobb 1992 Revocable Trust dated July 16, 1992, for which Cobb serves as trustee. In that capacity, Cobb has the authority to "prosecute or defend actions, claims, or proceedings for the protection of trust property." *Moeller v. Superior Court*, 16 Cal.4th 1124, 69 Cal.Rptr.2d 317, 947 P.2d 279, 284 (1997) (quoting Cal. Prob. Code § 16249). In such actions, "the trustee, rather than the trust, is the real party in interest." *Id.*, 69 Cal.Rptr.2d 317, 947 P.2d at 283 n.3. I accordingly refer to Cobb as the "owner" of the condemned parcel, and the parties have similarly stipulated that Cobb became the "owner of the [p]arcel by operation of state probate and trust succession following the death of [his father,] Andrew C. Cobb."

2 And with respect to the first equitable mootness factor—whether a stay was sought—it would be pointless for parties trying to have their claims excepted from discharge to be required to seek to stay a plan that they believe their claims should not be part of in the first place. Moreover, although Cobb did not seek a stay of the Plan, he was certainly diligent in pursuing his rights. *See In re Thorpe Insulation Co.*, 677 F.3d 869, 881 (9th Cir. 2012) (holding that "where a party has done nothing by its own inaction to encourage or permit developments to proceed without its participation, courts should be cautious about reaching a conclusion of equitable mootness"). Cobb argued in the bankruptcy court that his "claims in inverse condemnation are protected by the Fifth and Fourteenth Amendments to the United States Constitution and cannot be impaired by the Plan," and the bankruptcy court held a hearing and then ruled on this objection. As a result, contrary to the majority's suggestion, it was unnecessary for Cobb to seek a stay to afford the bankruptcy court an opportunity to rule on this issue.

3 And because Cobb, unlike the creditor in *Franklin*, seeks to proceed entirely outside the Plan, the City would be under no obligation to compensate him within the same timeframe in which it compensates the creditors covered by the Plan. *See infra* note 14.

4 I recognize that only a portion of the proof of claim that Cobb submitted in the bankruptcy proceeding is truly a claim for just compensation, and I would hold that Cobb's claim should be excepted from discharge only to the extent that it seeks

just compensation for the condemned parcel in excess of what he has already been paid. I do not believe that Cobb is entitled to shield from bankruptcy the portion of his claim that requests other forms of recovery, such as attorney's fees or insurance costs.

5 The Supreme Court later upheld the constitutionality of the amended Frazier-Lemke Act in *Wright v. Vinton Branch of Mountain Trust Bank*, 300 U.S. 440, 57 S.Ct. 556, 81 L.Ed. 736 (1937). Contrary to the majority's assertion, *Wright* does not undermine the Court's holding in *Radford* that the bankruptcy power is subject to the Takings Clause. Rather, *Wright* turned on the determination that the new Act had no significant impact on property rights at all. 300 U.S. at 457, 470, 57 S.Ct. 556; *see also Rodrock v. Sec. Indus. Bank*, 642 F.2d 1193, 1197–98 (10th Cir. 1981) (explaining that while subsequent cases "may well refine the rule of *Radford*, ... they do not destroy the fundamental teaching of *Radford* that Congress may not under the bankruptcy power completely take for the benefit of a debtor rights in specific property previously acquired by a creditor"), *aff'd sub nom. United States v. Sec. Indus. Bank*, 459 U.S. 70, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982).

6 The majority attempts to limit this line of cases to situations in which the government retroactively divests creditors of their property interests. But, even if it should be so limited, that is exactly the situation facing Cobb. To begin, there is no question that a taking occurred that divested Cobb of his interest in real property. He had an undisputed right to just compensation until the City filed for bankruptcy and attempted to eliminate that right retroactively.

Moreover, the majority fails to recognize the important distinction between the rights of land owners and the rights of secured creditors. Applying § 522(f) prospectively in *Security Industrial Bank* did not implicate constitutional concerns because the property interests of secured creditors are themselves "defined by reference to existing law." *See* James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 Harv. L. Rev. 973, 987 (1983). When a creditor "enter[s] into [a] security arrangement, he kn[ows] ... that his rights [a]re circumscribed by the federal legislation." *Id.* By contrast, legislation restricting rights in real property could never be entirely prospective. *Id.* at 987 n.59. In other words, "there can ... be new security arrangements," but there "can be no new land." *Id.* Accordingly, Cobb's claim implicates the same concerns that led the Supreme Court to limit retroactive application of the bankruptcy laws.

7 I note that the majority's contrary approach is at odds with the only other federal court that has addressed this question. The bankruptcy court adjudicating Detroit's municipal bankruptcy held that the Takings Clause prohibits the discharge in bankruptcy of pending claims for just compensation arising from already completed takings. *In re City of Detroit*, 524 B.R. 147, 270 (Bankr. E.D. Mich. 2014). There, creditors were slated to receive a fraction of their takings claim under Detroit's chapter 9 plan. *Id.* at 267. Because the proposed plan denied those creditors their constitutionally owed just compensation, the court held that it would violate the Fifth Amendment if confirmed. *Id.* at 270. The bankruptcy court thus provided in its confirmation order that the takings claims were excepted from discharge. *Id.*

8 This case presents a separate issue from cases adjudicating whether a taking has in fact occurred. The majority cites *In re George*, 322 F.3d 586 (9th Cir. 2003), for the proposition that we have approved a bankruptcy court's dismissal of a takings claim on the merits. There, we considered the application of 11 U.S.C. § 365(d)(4), which requires a bankruptcy trustee to assume or reject an "unexpired lease of nonresidential real property" within a particular timeframe to avoid having to surrender the property. 322 F.3d at 589 n.2 (quoting 11 U.S.C. § 365(d)(4)). We had previously clarified that, because the statute allows the debtor either to assume or to reject the lease, the statute does not itself result in an unconstitutional taking. *See In re Ariz. Appetito's Stores, Inc.*, 893 F.2d 216, 220 (9th Cir. 1990) (explaining that where a debtor does not move to assume a lease, it is the debtor's "own conduct" that results "in the rejection of the lease and the loss of its interest in the building"—not operation of the bankruptcy statute). In *In re George*, the debtors were required to surrender the leased property after they failed to take action during the relevant timeframe. 322 F.3d at 589. We concluded that there was no cognizable taking because, following the surrender, "the debtors ha[d] no valid right to possess or develop the property." *Id.* at 590. Accordingly, the debtors had "no right to be compensated at all, let alone justly." *Id.* at 591. Contrary to the majority's characterization, there was therefore no colorable takings claim for the bankruptcy court to have any impact on one way or the other. Here, by contrast, there is no question that a taking occurred that entitled Cobb to compensation.

9 To the extent the majority faults Cobb for not asserting a counterclaim for greater compensation in the eminent domain proceeding, the majority is mistaken. Because an eminent domain action will necessarily determine the compensation due to the property owner—indeed, that is the purpose of the action—a property owner is not required to separately counterclaim for more than the probable just compensation funds. In fact, the value of the probable just compensation funds "may not be given in evidence or referred to in the trial of the issue of compensation" during an eminent domain proceeding in California court. Cal. Civ. Proc. Code § 1255.060(a). This state procedural rule would make no sense if

a property owner had to bring a counterclaim to request compensation in excess of the deposited funds. Moreover, the City has never asserted that Cobb was required to bring a counterclaim for his requested compensation. Even assuming such a requirement existed, then, the City has forfeited any argument that Cobb failed to meet it. Finally, as the California Court of Appeal explained in concluding that Cobb's inverse condemnation action was still timely, a property owner is not required to bring an inverse condemnation action until the dismissal of the eminent domain proceeding. If Cobb had been required to assert a counterclaim for greater compensation, he would not have had a viable inverse condemnation claim that could even potentially have been time barred. The fact that the Court of Appeal held that Cobb's inverse condemnation action could proceed shows that the court implicitly concluded that Cobb was not required to bring a counterclaim in the eminent domain action.

10 *People ex rel. Department of Public Works v. Peninsula Title Guaranty Co.*, 47 Cal.2d 29, 301 P.2d 1 (1956), is not to the contrary. The majority invokes *Peninsula Title* for the proposition that formal title passage is not required to effect a change of ownership "[w]here there has been a prior physical 'taking.' " *Id.* at 3. But the question in *Peninsula Title* was whether a property owner who retains legal title remains liable for certain taxes after a public entity has already taken the property. *Id.* at 3–4. The California Supreme Court held that, under those circumstances, lack of a formal transfer of title should not operate to impose continued tax liability on a property owner who has already experienced "a divestiture for all practical purposes." *Id.* at 3. The issue in *Peninsula Title* was thus whether a property owner should continue to bear the *burdens* of ownership throughout the lengthy eminent domain process despite having effectively lost the property, not whether a property owner is deprived of the only *benefit* remaining to him at that point—the constitutional right to seek just compensation. The City has not cited any cases that support the latter proposition, nor has the majority. And, indeed, Cobb has continued to pay taxes on the parcel.

11 For these reasons, and contrary to the majority's assertion, Cobb's inverse condemnation claim should have been exempted from discharge even if it had already been reduced to judgment. Whether someone has an outstanding claim for just compensation or a judgment awarding him just compensation, he has a constitutional right to just compensation that neither a city nor Congress through its bankruptcy powers may extinguish.

12 I note that the Cobb family permitted the City to build a road only in the sense that they did not challenge the City's action for prejudgment possession. *See* Cal. Civ. Proc. Code § 1255.410(c). The Cobbs did not otherwise have a choice as to whether the City could proceed with construction.

13 It is irrelevant that Cobb did not appeal the Superior Court's rejection of his quiet title, ejectment, and trespass claims. Those claims seek relief that would essentially prohibit the City from continuing to use the land for a public road; such relief is no longer available to Cobb, *see Frustuck*, 28 Cal.Rptr. at 373, and the Superior Court accordingly held that the doctrine of intervening public use barred those claims. But *Frustuck* makes clear that Cobb can still pursue just compensation in an inverse condemnation action, *see id.*, and he appealed the Superior Court's dismissal of that claim.

14 Of course, where a creditor with a nondischargeable claim elects to sit out the bankruptcy entirely, the creditor loses the opportunity to participate in voting on or distribution under the plan. *Grynberg*, 986 F.2d at 370; *see also* Fed. R. Bankr. P. 3003(c)(2) (explaining that a creditor who does not file a proof of claim in a chapter 9 or chapter 11 proceeding "shall not be treated as a creditor with respect to such claim *for the purposes of voting and distribution*" (emphasis added)). And "[c]reditors holding nondischargeable debts who do not participate in the distribution of the debtor's estate under the plan take a large risk that the debtor will have nothing left after bankruptcy proceedings are concluded, and that although the debt has not been discharged, meaningful recovery will be postponed indefinitely." *Grynberg*, 986 F.2d at 370 n.4.

15 The only exception to the lack of a time limit—not applicable here—is for complaints filed under 11 U.S.C. § 523(c), which relates to debt incurred from fraud or willful and malicious injury. *In re Coleman*, 560 F.3d 1000, 1004 n.6 (9th Cir. 2009); *see also* 11 U.S.C. § 523(a)(3)(B).

16 To argue otherwise, the majority relies on facts from the Bankruptcy Appellate Panel's decision in a different challenge to the City's bankruptcy, *Franklin High Yield Tax-Free Income Fund v. City of Stockton*, 542 B.R. 261 (B.A.P. 9th Cir. 2015). There is no basis for incorporating statements—absent from the record here—that were made in a separate litigation in which Cobb was not a party. *See United States v. Joyce*, 511 F.2d 1127, 1132 (9th Cir. 1974) (explaining that "the facts found in one case are not evidence of those same facts in another case"). That the majority found it necessary to do so demonstrates the lack of evidence presented on the issue in *this* appeal. And, in fact, the bankruptcy court in the *Franklin* proceeding noted that with the City's "finances on more stable footing," it was possible that "additional funds could be made available to [creditors] ... and that could be done without disturbing in any way the payments to retirees." *Franklin*, 542 B.R. at 277.

17 Because of this distinction, the majority's reliance on *Bennett v. Jefferson Cty.*, 899 F.3d 1240 (11th Cir. 2018), is unwarranted. In *Bennett*, the Eleventh Circuit held that equitable mootness may bar consideration on appeal of

constitutional challenges to a chapter 9 plan, but the challenges the court considered related to voting rights and procedural due process, not the Takings Clause. *Id.* at 1243, 1250–51.

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902 F.3d 963
United States Court of Appeals, Ninth Circuit.

Jonathan Eldon HUNSAKER; Cheryl Lynn Hunsaker, Plaintiffs-Appellants,
v.
UNITED STATES of America, Defendant-Appellee.

No. 16-35991
|
Argued and Submitted May 15, 2018, Portland, Oregon
|
Filed August 30, 2018

Synopsis

Background: After debtors filed for bankruptcy, Internal Revenue Service (IRS) violated automatic stay by sending collection notices. The bankruptcy court awarded damages to debtors for their emotional distress. IRS appealed. The United States District Court for the District of Oregon, Michael J. McShane, J., reversed on sovereign immunity grounds. Debtors appealed.

The Court of Appeals, Cynthia A. Bashant, United States District Judge for the Southern District of California, sitting by designation, held that award of emotional distress damages against United States for willful violation of Bankruptcy Code's automatic stay fell within waiver of sovereign immunity.

Reversed and remanded.

Attorneys and Law Firms

***964** Douglas D. Geyser (argued) and Daniel L. Geyser, Stris & Maher LLP, Los Angeles, California; Keith D. Karnes, Karnes Law Offices P.C., Salem, Oregon; for Plaintiffs-Appellants.

Paul Andrew Allulis (argued) and Thomas J. Clark, Attorneys; David A. Hubbert, Acting Assistant Attorney General; Tax Division, United States Department of Justice, Washington, D.C.; for Defendant-Appellee.

Tara Twomey, National Consumer Bankruptcy Rights Center, San Jose, California, for Amici Curiae National Association of Consumer Bankruptcy Attorneys and National Consumer Bankruptcy Rights Center.

Appeal from the United States District Court for the District of Oregon, Michael J. McShane, District Judge, Presiding, D.C. No. 6:16-cv-00386-MC

Before: M. Margaret McKeown and Richard A. Paez, Circuit Judges, and Cynthia A. Bashant, [*] District Judge.

OPINION

BASHANT, District Judge:

***965** We must determine whether sovereign immunity precludes an award of emotional distress damages against the United States for willful violation of the Bankruptcy Code's automatic stay. The answer turns on the interplay between two Bankruptcy Code statutes: 11 U.S.C. §§ 106(a) ("Section 106(a)") and 362(k) ("Section 362(k)"). In Section 106(a), Congress waived sovereign immunity for a "money recovery" under certain bankruptcy provisions, including Section 362(k). Section 362(k) in turn allows an individual to recover "actual damages" for a willful violation of the Bankruptcy Code's automatic stay.

After Jonathan and Cheryl Hunsaker filed for bankruptcy, the Internal Revenue Service ("IRS") violated the automatic stay by sending the couple collection notices. The bankruptcy court awarded the Hunsakers damages under Section 362(k) for their emotional distress, but the district court reversed on sovereign immunity grounds. Because Section 106(a) unambiguously waives sovereign immunity for an award of emotional distress damages under Section 362(k), we reverse and remand.

I.

The Hunsakers filed for relief under Chapter 13 of the Bankruptcy Code. Despite being notified of the couple's bankruptcy, the IRS sent four notices to the Hunsakers demanding payment and threatening imminent enforcement action, including a levy on Social

Security benefits. The Hunsakers responded by bringing an adversary proceeding against the United States in bankruptcy court seeking damages for violation of the automatic stay under Section 362(k). The government conceded the IRS's conduct violated the stay.

At trial, the Hunsakers sought only damages for emotional distress. The government argued sovereign immunity bars this relief, but the bankruptcy court was unconvinced. In reaching the merits, the court determined that the IRS's conduct exacerbated the stress of the Hunsakers' bankruptcy, causing them to suffer significant emotional distress. As compensation, the court awarded the Hunsakers $4,000 in damages.

In an appeal to the district court, the government again invoked sovereign immunity. The government also challenged the merits of the Hunsakers' claims, arguing they suffered insufficient emotional distress to warrant damages. The district court concluded Congress has not waived sovereign immunity for emotional distress damages under Section 362(k). The court ***966** therefore reversed the bankruptcy court's judgment and ordered the Hunsakers' complaint to be dismissed, without reaching the merits of their claims. The Hunsakers appealed.

II.

We have jurisdiction under 28 U.S.C. § 158(d). We review de novo questions of statutory interpretation and sovereign immunity. *See Zazzali v. United States (In re DBSI, Inc.)*, 869 F.3d 1004, 1007 n.2 (9th Cir. 2017); *Montana v. Goldin (In re Pegasus Gold Corp.)*, 394 F.3d 1189, 1193 (9th Cir. 2005).

III.

"Sovereign immunity shields the United States from suit absent a consent to be sued that is 'unequivocally expressed.' " *United States v. Bormes*, 568 U.S. 6, 9–10, 133 S.Ct. 12, 184 L.Ed.2d 317 (2012) (quoting *United States v. Nordic Vill., Inc.*, 503 U.S. 30, 33–34, 112 S.Ct. 1011, 117 L.Ed.2d 181 (1992)). "Congress has enacted several broad waivers of the United States' sovereign immunity." *Navajo Nation v. Dep't of the Interior*, 876 F.3d 1144, 1168 (9th Cir. 2017).

The waiver at issue here, Section 106(a), applies to fifty-nine provisions of the Bankruptcy Code. For these enumerated provisions, Section 106(a) provides that "sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section." The extent of the waiver relevant to this appeal is set forth in Section 106(a)(3), which authorizes a court to "issue against a governmental unit an order, process, or judgment under such sections ... , including an order or judgment awarding a money recovery, but not including an award of punitive damages."

One of the waiver's enumerated provisions, Section 362, is the Bankruptcy Code's automatic stay statute. When debtors file for bankruptcy, Section 362 imposes an automatic stay "to protect debtors from all collection efforts while they attempt to regain their financial footing." *Schwartz v. United States (In re Schwartz)*, 954 F.2d 569, 571 (9th Cir. 1992). Section 362(k) establishes consequences for violating the stay: "an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages." In *Dawson v. Washington Mutual Bank, F.A. (In re Dawson)*, 390 F.3d 1139, 1148 (9th Cir. 2004), we held "actual damages" under Section 362(k) "include[s] damages for emotional distress." [1]

Relying on Section 362(k) and *Dawson*, the bankruptcy court awarded the Hunsakers emotional distress damages against the government. Because Section 106(a)'s waiver of sovereign immunity applies to Section 362(k), this appeal turns on whether the bankruptcy court's award falls within the scope of the waiver. That is, we must resolve whether an award of emotional distress damages is an "order or judgment awarding a money recovery, but not including an award of punitive damages." *See* 11 U.S.C. § 106(a)(3).

We conclude that it is. We first explain why the scope of Section 106(a)'s waiver of sovereign immunity is unambiguous and encompasses damages for emotional distress under Section 362(k). We then address the government's alternative, implausible interpretation of the waiver based on the term "money recovery" in ***967** Section 106(a)(3). Finally, we address our departure from the First Circuit's decision reaching the opposite result in an analogous context.

A.

"To maintain a suit against the government for money damages, 'the waiver of sovereign immunity must extend unambiguously to such monetary claims,' thus foreclosing an implied waiver." *Daniel v. Nat'l Park Serv.*, 891 F.3d 762, 768 (9th Cir. 2018) (quoting *Lane v. Pena*, 518 U.S. 187, 192, 116 S.Ct. 2092, 135 L.Ed.2d 486 (1996)). "Ambiguity exists if there is a plausible interpretation of the statute that would not authorize money damages," and we "construe any ambiguities in the scope of a waiver in favor of the sovereign." *FAA v. Cooper*, 566 U.S. 284, 290–91, 132 S.Ct. 1441, 182 L.Ed.2d 497 (2012).

Although a waiver of sovereign immunity must be unequivocally expressed, "Congress need not state its intent" to waive the government's immunity "in any particular way" or "use magic words." *Cooper*, 566 U.S. at 291, 132 S.Ct. 1441. "The sovereign immunity canon is just that—a canon of construction." *Richlin Sec. Serv. Co. v. Chertoff*, 553 U.S. 571, 589, 128 S.Ct. 2007, 170 L.Ed.2d 960 (2008). It is an interpretive tool that "does not 'displac[e] the other traditional tools of statutory construction.' " *Cooper*, 566 U.S. at 291, 132 S.Ct. 1441 (alteration in original) (quoting *Chertoff*, 553 U.S. at 589, 128 S.Ct. 2007).

Our inquiry, then, is whether the scope of the waiver is "clearly discernable from the statutory text in light of traditional interpretive tools." *Cooper*, 566 U.S. at 291, 132 S.Ct. 1441. If it is not, we will adopt the interpretation of the waiver that is most favorable to the government. *Id.*; *see also In re DBSI*, 869 F.3d at 1013 ("[W]here a plausible interpretation of a provision that would preserve immunity is available, we should adopt that interpretation and preserve the government's sovereign immunity.").

Turning to our interpretive tools, "we start with the plain meaning of the statute's text." *Father M v. Various Tort Claimants (In re Roman Catholic Archbishop of Portland in Or.)*, 661 F.3d 417, 432 (9th Cir. 2011) (quoting *United States v. Wright*, 625 F.3d 583, 591 (9th Cir. 2010)). "The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole." *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341, 117 S.Ct. 843, 136 L.Ed.2d 808 (1997).

Section 106(a)'s text plainly waives sovereign immunity for court-ordered monetary damages under the waiver's enumerated provisions, although the damages may not be punitive. Under Section 106(a)(3), a court is authorized to issue against the government an "order, process, or judgment under" the provisions identified in Section 106(a)(1), "including an order or judgment awarding a money recovery, but not including an award of punitive damages." The clause "including ... a money recovery" expressly broadens the waiver's scope to encompass monetary damages. The text then provides for one limitation: the money recovery cannot "includ[e] an award of punitive damages." Thus, the statute's text unambiguously waives sovereign immunity for nonpunitive monetary damages under the waiver's listed provisions. [2] And because Section 106(a)(3)'s language is unambiguous, the scope of the ***968** waiver is "clearly discernable from the statutory text in light of traditional interpretive tools." *See Cooper*, 566 U.S. at 291, 132 S.Ct. 1441.

In light of this unambiguous scope, Section 106(a) waives sovereign immunity for emotional distress damages under Section 362(k). Emotional distress damages are a form of monetary relief—compensatory damages—but they are not punitive. [3] We have already determined that damages for emotional distress are recoverable as "actual damages" under Section 362(k). *Dawson*, 390 F.3d at 1148. And, given that Section 106(a) waives immunity for nonpunitive monetary damages awarded under the statute's enumerated provisions, the bankruptcy court's award falls within the scope of the waiver. In other words, the court's award is a "judgment awarding a money recovery, but not including an award of punitive damages." *See* 11 U.S.C. § 106(a)(3).

Finally, because the scope of the waiver is unambiguous, "judicial inquiry is complete," and there is no need to look beyond the plain meaning of Section 106(a). *See Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 254, 112 S.Ct. 1146, 117 L.Ed.2d 391 (1992) (quoting *Rubin v. United States*, 449 U.S. 424, 430, 101 S.Ct. 698, 66 L.Ed.2d 633 (1981)). There is also no need to subject Section 362(k) to the same scrutiny as Section 106(a). Section 362(k) "is not a waiver of sovereign immunity; it is a substantive provision" that provides individuals relief for willful violations of the Bankruptcy Code's automatic stay. *See Gomez-Perez v. Potter*, 553 U.S. 474,

491, 128 S.Ct. 1931, 170 L.Ed.2d 887 (2008) (drawing this distinction between an analogous pair of statutes in the Age Discrimination in Employment Act of 1967). Because Section 106(a) waives sovereign immunity for claims under Section 362(k), the latter provision "need not ... be construed in the manner appropriate to waivers of sovereign immunity." *See United States v. Mitchell*, 463 U.S. 206, 218–19, 103 S.Ct. 2961, 77 L.Ed.2d 580 (1983); *accord Gomez-Perez*, 553 U.S. at 491, 128 S.Ct. 1931.

In sum, the Hunsakers may recover emotional distress damages against the government under Section 362(k) because Section 106(a)'s waiver of sovereign immunity "extend[s] unambiguously to such monetary claims." *See Daniel*, 891 F.3d at 768 (quoting *Lane*, 518 U.S. at 192, 116 S.Ct. 2092).

B.

The government argues for an alternative interpretation of Section 106(a)'s waiver based on the term "money recovery," which appears only in Section 106(a)(3)'s clause providing for "an order or judgment awarding a money recovery, but not including an award of punitive damages." In the government's view, "money recovery" can be construed "to refer only to claims seeking to restore to the bankruptcy estate sums of money unlawfully in the possession of governmental entities—not to the broader measure of damages."

The government's position is based on the Supreme Court's decision interpreting the prior version of Section 106 in ***969** *United States v. Nordic Village, Inc.*, 503 U.S. 30, 112 S.Ct. 1011, 117 L.Ed.2d 181 (1992). This prior version of Section 106 provided that a bankruptcy provision containing the term " 'creditor,' 'entity,' or 'governmental unit' applies to governmental units," and a court's determination "of an issue arising under such a provision binds governmental units." 11 U.S.C. § 106(c) (Supp. III 1979), *amended by* 11 U.S.C. § 106 (1994). The Supreme Court considered whether this language waived immunity for a trustee's action to recover an unauthorized payment made to the IRS after the debtor had filed for bankruptcy. *Nordic Vill.*, 503 U.S. at 31, 112 S.Ct. 1011. The Court held the statute did not waive sovereign immunity for the trustee's action because the statute's text failed to unequivocally subject the government to "claims for monetary relief." *Id.* at 39, 112 S.Ct. 1011.

"Congress amended Section 106(a)(1) in 1994, at least in part, as a response to *Nordic Village*." *In re DBSI*, 869 F.3d at 1011 n.8 (citing H.R. Rep. 103-835, at 42 (1994)). Using this backdrop as a springboard, the government argues "money recovery" can be interpreted as only allowing for the relief the Supreme Court held was unavailable in *Nordic Village*—the recovery of money unlawfully in the government's possession.

We reject this interpretation because it is not plausible in light of the statute's text. In particular, Section 106(a)(3)'s exclusion of punitive damages dispels the government's interpretation. In this provision, the phrase "judgment awarding a money recovery" is immediately followed by the carve-out "but not including an award of punitive damages." 11 U.S.C. § 106(a)(3). If "money recovery" is limited, however, to recovering "sums of money unlawfully in the possession of governmental entities," the punitive damages carve-out is meaningless. Punitive damages are not "sums of money unlawfully in the possession of governmental entities."

Given that the government's interpretation of "money recovery" renders part of the statute meaningless, this interpretation runs afoul of "one of the most basic interpretive canons, that '[a] statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant[.]' " *See Corley v. United States*, 556 U.S. 303, 314, 129 S.Ct. 1558, 173 L.Ed.2d 443 (2009) (first alteration in original) (quoting *Hibbs v. Winn*, 542 U.S. 88, 101, 124 S.Ct. 2276, 159 L.Ed.2d 172 (2004)). For this reason, the government's construction of Section 106(a) is implausible. *See Cooper*, 566 U.S. at 290–91, 132 S.Ct. 1441. And we cannot rely on an implausible construction of the statute to preserve the government's immunity. *See id.*; *see also In re DBSI*, 869 F.3d at 1013. We instead afford Section 106(a) its plain meaning: Congress has waived sovereign immunity for nonpunitive monetary damages under the waiver's enumerated provisions, including Section 362(k).

C.

We recognize the First Circuit reached a different result when construing the scope of Section 106(a)'s waiver in *United States v. Rivera Torres (In re Rivera Torres)*,

432 F.3d 20 (1st Cir. 2005). We briefly turn to the First Circuit's opinion and explain why we disagree with its reasoning.

In *Rivera Torres*, the First Circuit analyzed whether Section 106(a) waives sovereign immunity for emotional distress damages awarded under a different provision enumerated in the waiver: 11 U.S.C. § 105. 432 F.3d at 23. In resolving this issue, the First Circuit adopted a "temporal approach." *Id.* at 25. This approach focuses on whether Congress understood emotional distress damages to be available under Section 106(a)'s enumerated provisions at the time of the 1994 amendment to the ***970** statute. *Id.* The First Circuit reasoned that "congressional understanding" can be evaluated by considering the "background law" at the time of the amendment. *See id.* at 25–26.

After surveying the state of the law in 1994, the First Circuit concluded that none of the relevant provisions enumerated in Section 106(a)(1) "clearly established the availability, even against private parties, of an award of emotional distress damages in 1994 as a matter of background law." *Rivera Torres*, 432 F.3d at 29. Thus, the First Circuit reasoned these enumerated sections "do not provide a basis to find [a] clear waiver of sovereign immunity as to emotional distress damages." *Id.*

We decline to adopt the First Circuit's temporal approach to Section 106(a) for several reasons. First, the plain language of the statute is dispositive. Because the scope of Section 106(a)'s waiver is unambiguous, there is no need to look beyond the statute's text and ascertain whether it was clearly established in 1994 that emotional distress damages were recoverable under Section 362(k). *See, e.g.*, *Germain*, 503 U.S. at 253–54, 112 S.Ct. 1146 ("We have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there.").

Second, we disagree with the First Circuit's interpretation of Section 106(a)(5), which the First Circuit relied upon to tether its temporal approach to the statute's text. Section 106(a)(5) provides: "Nothing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law." In the First Circuit's view, this text limits Section 106(a)'s waiver to only those remedies that were available at the time of the 1994 amendment because the text "forbids the creation of any substantive claim for relief 'not otherwise existing under this title, the Federal Rules of Bankruptcy, or nonbankruptcy law.' " *See Rivera Torres*, 432 F.3d at 31 (quoting 11 U.S.C. § 106(a)(5)). And, based on Section 106(a)(5), the First Circuit reasoned that "Congress has clearly endorsed a temporal approach." *Id.* at 26.

We do not read the same temporal restriction into Section 106(a)(5). Section 106(a)(5) only states that Section 106(a)—a provision waiving immunity for various substantive provisions—does not itself create any new causes of action or substantive claims for relief. *See Franklin Sav. Corp. v. United States (In re Franklin Sav. Corp.)*, 385 F.3d 1279, 1286 (10th Cir. 2004) ("By its express terms ... Bankruptcy Code § 106 does not provide a substantive or independent basis for asserting a claim against the government."). In other words, Section 106(a)(5) confirms that a party bringing a claim against the government "must demonstrate that a source *outside* of" the waiver provision "entitles [it] to the relief sought." *See In re Hardy*, 97 F.3d at 1388. This section does not graft a temporal restriction into the waiver's scope.

Third, Section 362(k) predates the operative text of Section 106(a). Although we interpreted Section 362(k) to provide for emotional distress damages in *Dawson* in 2004—ten years after Congress enacted the relevant text in Section 106(a)—Section 362(k) has always permitted recovery of damages for emotional distress. *See Rivers v. Roadway Express, Inc.*, 511 U.S. 298, 312–13, 114 S.Ct. 1510, 128 L.Ed.2d 274 (1994) ("A judicial construction of a statute is an authoritative statement of what the statute meant before as well as after the decision of the case giving rise to that construction.").

For these reasons, we decline to adopt the First Circuit's temporal approach and ***971** rest our interpretation of Section 106(a) on the statute's plain text. [4]

IV.

In sum, sovereign immunity does not preclude an award of emotional distress damages against the United States for willful violation of the Bankruptcy Code's automatic stay. The district court erred in ordering the bankruptcy court to dismiss the Hunsakers' complaint on sovereign immunity grounds. Accordingly, we reverse the district

court's judgment, and we remand to the district court with instructions to consider the government's challenge to the merits of the Hunsakers' claims. *See, e.g.*, *Mastro v. Rigby*, 764 F.3d 1090, 1097 (9th Cir. 2014) ("When a district court improperly dismisses a bankruptcy appeal without reaching the merits, we generally reverse the district court's dismissal and remand for the district court's consideration of the appeal in the first instance.").

REVERSED AND REMANDED.

All Citations

902 F.3d 963, 122 A.F.T.R.2d 2018-5711, 2018-2 USTC P 50,397, 66 Bankr.Ct.Dec. 47, Bankr. L. Rep. P 83,295, 18 Cal. Daily Op. Serv. 8776, 2018 Daily Journal D.A.R. 8753

Footnotes

* The Honorable Cynthia A. Bashant, United States District Judge for the Southern District of California, sitting by designation.

1 When we decided *Dawson*, Section 362(k) was labeled Section 362(h). Congress redesignated the statute as Section 362(k) in 2005, but the relevant text remains unchanged. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 305(1)(B), 119 Stat. 23, 79.

2 The Eleventh Circuit has adopted the same interpretation of the scope of Section 106(a)'s sovereign immunity waiver. *See Hardy v. United States (In re Hardy)*, 97 F.3d 1384, 1390 (11th Cir. 1996).

3 These damages compensate for an actual injury: distress. "Distress is a personal injury familiar to the law" that "include[s] mental suffering or emotional anguish." *See Carey v. Piphus*, 435 U.S. 247, 263–64, 264 n.20, 98 S.Ct. 1042, 55 L.Ed.2d 252 (1978) (discussing the standard for awarding emotional distress damages as compensatory damages under 42 U.S.C. § 1983). In contrast, punitive damages "are not compensation for injury"; they are instead awarded "to punish reprehensible conduct and to deter its future occurrence." *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 350, 94 S.Ct. 2997, 41 L.Ed.2d 789 (1974).

4 We note that, even under a temporal approach, some bankruptcy courts had awarded emotional distress damages for willful violations of the automatic stay before the enactment of Section 106(a) in 1994. *See Brower Oil Co. v. Brannen (In re Brannen)*, Ch. 7 Case No. 89-60229, Adv. No. 89-6011, 1990 WL 10007473, at *4 (Bankr. S.D. Ga. June 27, 1990); *Wagner v. Ivory (In re Wagner)*, 74 B.R. 898, 905 (Bankr. E.D. Pa. 1987); *Mercer v. D.E.F., Inc. (In re Mercer)*, 48 B.R. 562, 565 (Bankr. D. Minn. 1985).

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See Fed. Rule of Appellate Procedure 32.1
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See also U.S.Ct. of App. 10th Cir. Rule 32.1.
United States Court of Appeals, Tenth Circuit.

IN RE: EUROGAS, INC., Debtor.
The Slovak Republic, Appellant,
v.
Elizabeth R. Loveridge, Chapter 7 Trustee, EuroGas, Inc., and Texas Euro Gas Corp., Appellees.

No. 17-4197
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Attorneys and Law Firms

Mona Lyman Burton, Doyle S. Byers, Engels Tejeda, Holland & Hart, Salt Lake City, UT, for Debtor

Michael R. Johnson, Esq., Brent D. Wride, Ray Quinney & Nebeker, Salt Lake City, UT, for Appellant

Reid W. Lambert, Elizabeth E. Rose Loveridge, Strong & Hanni, Salt Lake City, UT, for Appellee Elizabeth E Rose Loveridge

Mona Lyman Burton, Doyle S. Byers, Engels Tejeda, Holland & Hart, Salt Lake City, UT, for Appellee EuroGas, Inc.

Matthew L. Anderson, Fabian VanCott, Salt Lake City, UT, Jarrod Martin, Nathan Sommers Jacobs, Houston, TX, for Appellee Texas Euro Gas Corp.

Before BACHARACH, EBEL, and MORITZ, Circuit Judges.

ORDER AND JUDGMENT *

David M. Ebel, Circuit Judge

***1** This appeal stems from the Chapter 7 bankruptcy of EuroGas, Inc. ("EuroGas I"). The Slovak Republic, an unsecured creditor who filed a claim in that bankruptcy, appeals the decision of the Tenth Circuit Bankruptcy Appellate Panel ("BAP") dismissing its appeal for lack of prudential standing and, in the alternative, ruling against it on the merits. On the merits, the BAP affirmed the bankruptcy court's approval of an agreement between the trustee and another entity disposing of some of the estate's assets. Specifically, the agreement required the trustee to abandon any interests the estate had in certain talc deposits located in the Slovak Republic in exchange for $250,000 and the withdrawal of a $113 million claim against the estate. The Slovak Republic challenges that agreement as an improper abandonment of assets under 11 U.S.C. § 554(a). Exercising jurisdiction under 28 U.S.C. § 158(d), we assume without deciding that the appellant-creditor has prudential standing and then we conclude that the bankruptcy court did not clearly err in finding that retention of the talc claims would have been burdensome to the estate under 11 U.S.C. § 554.

I. BACKGROUND

A. EuroGas I's Bankruptcy Proceedings

EuroGas I was formed as a Utah Corporation in 1985. The company was administratively dissolved in 2001 for failure to file an annual report and for failure to pay the annual fee required by Utah law. On November 15, 2005, EuroGas II, a successor entity with the same name and same officers as EuroGas I, was incorporated in the state of Utah.

This Chapter 7 bankruptcy was initiated on May 18, 2004 when judgment creditor W. Steve Smith filed an involuntary petition of bankruptcy against EuroGas I in the District of Utah bankruptcy court. Smith had obtained judgments against EuroGas I while acting as trustee for various other bankruptcy estates. Particularly relevant here, Smith received a judgment against EuroGas I in the amount of $113,371,837.65 in June 2004 from the Southern District of Texas. This judgment was filed as Claim 1-1 in EuroGas I's bankruptcy. Texas Euro Gas ("TEG") acquired Claim 1–1 from Smith in September 2007. The trustee of EuroGas I's bankruptcy distributed approximately $700,000 to creditors, the majority of which went to TEG, due to the substantial size of Claim 1-1. The case closed on March 19, 2007.

In September 2015, upon motion from the U.S. Trustee, the bankruptcy court reopened EuroGas I's bankruptcy case to investigate the ownership of certain interests in talc deposits located in the Slovak Republic ("talc claims") that were undisclosed in EuroGas I's initial bankruptcy proceeding. It was alleged that the talc claims were property of the bankruptcy estate of EuroGas I being unlawfully held by EuroGas II. The U.S. Trustee appointed Elizabeth Loveridge ("Trustee") to serve as the trustee for the estate in the reopened bankruptcy proceeding.

Sometime between the close and reopening of EuroGas I's bankruptcy case, EuroGas II initiated an arbitration proceeding before the International Centre for Settlement of Investment Disputes in France, seeking resolution of the dispute regarding ownership of the talc claims. The Slovak Republic was also party to the arbitration. Although the arbitration has since been closed, it was ongoing at the time the bankruptcy court issued the order that underlies this appeal. [1]

B. Abandonment of the Talc Claims

***2** After EuroGas I's bankruptcy was reopened, the Trustee investigated the talc claims and communicated with the parties in interest and their representatives. After concluding that the bankrupt estate's ownership of the talc claims was uncertain and that the claims would be difficult and expensive to administer, the Trustee entered into an agreement with EuroGas II ("Agreement") to dispose of the claims. The major financial terms of the Agreement were as follows: EuroGas II agreed to remit $250,000 to the Trustee and TEG agreed to withdraw Proof of Claim 1-1 in exchange for the Trustee filing, and the bankruptcy court approving, a Notice of Abandonment of any remaining interest that the estate still had in the talc claims. After making this agreement with EuroGas II, the Trustee filed a Motion to Approve Agreement and a Notice of Proposed Abandonment with the bankruptcy court on August 18, 2016.

On August 19, 2016, the Slovak Republic purchased two claims worth $240,181 each from a creditor of EuroGas I and, as a result, became an unsecured creditor in the reopened bankruptcy case. Then, the Slovak Republic promptly filed an objection to the Trustee's motion and notice and an objection to Claim 1-1.

C. The Bankruptcy Court's Opinion

The bankruptcy court held an evidentiary hearing on the Trustee's motion during which the Trustee, the Slovak Republic, EuroGas II, and TEG presented oral argument, called witnesses to testify, and submitted other evidence.

The Trustee testified that, after significant investigation, she was unable to determine whether the talc claims remained with the bankruptcy estate or were abandoned when the case was closed in 2007. She also noted that, even if she could determine the estate's ownership over the talc claims, the talc claims could not be liquidated easily because they were the subject of the international arbitration involving EuroGas II and the Slovak Republic. She also testified that intervening in the international arbitration to assert the estate's rights to the talc claims would cost between $1.5 and 2 million in legal fees, a sum the estate could not afford. The Trustee explained in her Notice of Proposed Abandonment that "the estate ha[d] no resources with which to pursue the Talc Claims." (App. 146–47). Finally, the Trustee testified that she considered different agreement offers from EuroGas II and the Slovak Republic, but ultimately chose the EuroGas II offer.

Initially, the Slovak Republic offered to fund any adversary proceedings necessary to determine the estate's ownership in the talc claims and then to purchase the talc claims if the Trustee discovered the estate was entitled to them. As already described, EuroGas II made a competing offer to pay the Trustee $250,000 and to have TEG withdraw Claim 1-1 if the Trustee agreed to abandon the talc claims. The Trustee accepted this offer and executed the Agreement with EuroGas II and filed her Notice of Abandonment with the bankruptcy court. The Slovak Republic then made a new offer to purchase the talc claims on a quitclaim basis for $250,000. The Trustee testified that she decided to maintain the Agreement with EuroGas II because she concluded that it was the best deal for the estate's creditors.

After considering all of the evidence, the bankruptcy court approved the Notice of Abandonment and granted the Motion to Approve Agreement. The bankruptcy court approved the Notice of Abandonment pursuant to 11 U.S.C. § 554(a) because it determined that the talc claims were both "burdensome" and "of inconsequential value and benefit to the estate." 11 U.S.C. § 554(a). The

bankruptcy court found that the Trustee's testimony at the hearing was credible. Based on that testimony and other evidence presented at the hearing, the bankruptcy court made the following findings:

1. It was uncertain whether the talc claims were property of the estate or whether they were abandoned in 2007.

***3** 2. The talc claims were, at the time, subject to litigation before the arbitration tribunal.

3. The issue of ownership of the talc claims was complex.

4. It would require expensive litigation to determine whether the estate owned the talc claims.

5. If the Trustee had not abandoned the talc claims, she would have had to either initiate or defend litigation about the ownership of the talc claims.

6. It was uncertain whether the Trustee would be successful in litigation to determine the ownership status of the talc claims.

7. The talc claims were not easily administrable because they were not liquid claims.

8. TEG's claim (Claim 1-1) is not clearly objectionable, but instead has some basis for it.

Based on its findings, the court determined that the talc claims were burdensome and of inconsequential value to the estate.

The bankruptcy court acknowledged that Slovak Republic offered to purchase the talc claims for $250,000 on a quitclaim basis but explained that it would not "second-guess the Trustee's business judgment when she has so credibly explained her grounds for decision." (App. 425).

The bankruptcy court also granted the Trustee's Motion to Approve Agreement by treating the Agreement as a Federal Rule of Bankruptcy Procedure Rule 9019 settlement agreement under In re Kopexa Realty Venture Co., 213 B.R. 1020, 1022 (10th Cir. BAP 1997). In its appellate briefs to this court, the Slovak Republic argued that the bankruptcy court abused its discretion by approving the Agreement under Kopexa rather than treating it as a sale of assets. However, at oral argument, counsel for the Slovak Republic conceded that, if we find that the talc claims were properly abandoned, "that would be dispositive." (Oral Arg. Rec., 7:10-7:31). We agree that our holding that abandonment is proper resolves this appeal and therefore do not address the Slovak Republic's Rule 9019 argument.

D. The Bankruptcy Appellate Panel's Opinion

The Slovak Republic appealed the bankruptcy court's order to the BAP, and EuroGas II responded with a motion to dismiss the Slovak Republic's appeal for lack of standing. The BAP issued an opinion that drew two, alternative conclusions. First, the BAP held that the Slovak Republic lacked prudential standing to appeal the bankruptcy court's order. Second, the BAP held that the Slovak Republic's arguments failed on the merits because the bankruptcy court did not abuse its discretion by authorizing the Trustee to abandon the talc claims or by approving the Agreement.

The BAP held that the Slovak Republic lacked prudential standing because it was not a "person aggrieved," meaning it failed to demonstrate that its rights were "directly and adversely affected pecuniarily by the decree or order of the bankruptcy court." In re Am. Ready Mix, Inc., 14 F.3d 1497, 1500 (10th Cir. 1994). The BAP determined that the Slovak Republic was not aggrieved by the bankruptcy court's approval of the Agreement as an unsecured creditor because the Agreement increased dividends paid to unsecured creditors without creating any demonstrable harm. Second, the BAP determined that the Slovak Republic abandoned its argument that it was aggrieved by the Agreement as a participant in the international arbitration by failing to raise that point at oral argument. [2]

***4** In the alternative, the BAP concluded that the Slovak Republic's arguments failed substantively. The BAP held that the bankruptcy court did not abuse its discretion by authorizing the trustee to abandon the talc claims because it agreed with the bankruptcy court that the talc claims were burdensome and of inconsequential value to the estate. The BAP next held that the bankruptcy court did not abuse its discretion by evaluating the Agreement as a settlement rather than a sale and properly applied the Kopexa factors.

The Slovak Republic now appeals to this court, arguing that it has standing to appeal and that the bankruptcy

court erred by authorizing the Trustee to abandon the talc claims.

II. DISCUSSION

In bankruptcy appeals, this court independently reviews the bankruptcy court's orders, examining legal determinations de novo and factual findings for clear error. FB Acquisition Prop. I, LLC v. Gentry, 807 F.3d 1222, 1225 (10th Cir. 2015). "The BAP is a subordinate appellate court not entitled to deference, but its rulings are often persuasive." C.W. Mining Co. v. Aquila, Inc., 625 F.3d 1240, 1244 (10th Cir. 2010).

As a threshold matter, we assume without deciding that the Slovak Republic has prudential standing to appeal the bankruptcy court's order. Prudential standing is a question of law that the court considers de novo. In re Weston, 18 F.3d 860, 862 (10th Cir. 1994). This circuit has adopted the rule that appellate review of a bankruptcy court order is limited to "persons aggrieved" by that order. In re C.W. Mining Co., 636 F.3d 1257, 1260 (10th Cir. 2011). A "person aggrieved" is a person whose rights or interests are "directly and adversely affected pecuniarily by the decree or order of the bankruptcy court." Id. This standing rule is a prudential limitation, not an Article III limitation. Id. at 1260 n.5. Because prudential standing is non-jurisdictional, we may assume without deciding that its elements are met. Id. We take that approach in this case and assume that the Slovak Republic is a person aggrieved. [3] Accordingly, we also deny Euro Gas II's motion to dismiss.

Moving to the merits, we conclude that the bankruptcy court did not error by authorizing the Trustee to abandon the talc claims because the talc claims were burdensome to the estate.

The Slovak Republic asserts that the bankruptcy court reversibly erred when it authorized the Trustee to abandon the talc claims. Section 554(a) of the Bankruptcy Code provides, in pertinent part, as follows:

> After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.

11 U.S.C § 554(a). We agree with the bankruptcy court that the Trustee properly exercised its authority to abandon the talc claims under section 554(a) because they were burdensome to the estate.

The parties disagree over the correct standard of review: The Slovak Republic argues that our review is de novo; EuroGas II and the Trustee urge application of the abuse-of-discretion standard. The BAP likewise identified abuse of discretion as the standard of review for considering a bankruptcy court's rulings on abandonment. But it seems to us that each of these views may be too simplistic. When deciding whether to allow or disallow a trustee to abandon an asset, a bankruptcy judge must tackle four kinds of issues—the first legal, the second factual, the third a mixed question of law and fact, and the fourth discretionary. Cf. U.S. Bank Nat'l Assoc. v. Village at Lakeridge, LLC, —— U.S. ——, 138 S.Ct. 960, 965–69, 200 L.Ed.2d 218 (2018) (analyzing the legal, factual, and mixed questions that a bankruptcy judge must answer to decide whether a particular creditor is a "non-statutory insider"). In our case, it seems that a bankruptcy court must (1) identify the legal definition of the terms "burdensome" and "inconsequential," (2) make findings of fact about the contested asset, (3) determine whether its findings of fact satisfy the legal test for whether an asset is "burdensome" or "inconsequential," and, finally, (4) if it concludes that the property is burdensome or inconsequential, determine if the trustee abused its discretion ("may abandon") by choosing to abandon the asset. In such a case, appellate courts should treat the steps in the decision-making process as distinct, applying the appropriate standard of review to each. See id. We follow that approach here.

***5** The first step is to identify the definition of the terms "burdensome" or "inconsequential," a legal determination we review de novo. See id. at 965; 11 U.S.C. § 554(a). We focus on "burdensomeness" for this case. Section 554 "serves the purpose of expeditious and equitable distribution by permitting the trustee to abandon property that consumes the resources and drains the income of the estate." In re Smith-Douglass, Inc., 856 F.2d 12, 16 (4th Cir. 1988). Property is burdensome to an estate if the expected cost of administering the asset would exceed the expected benefit. In re K.C. Mach.

& Tool Co., 816 F.2d 238, 246 (6th Cir. 1987). The cost of administering an asset might exceed the benefit when the asset is encumbered with liens in excess of its value, Federal Land Bank of Berkeley v. Nalder, 116 F.2d 1004 (10th Cir. 1941); In re Rich, 510 B.R. 366 (Bankr. D. Utah 2014), or when the value of the asset can be realized only through expensive litigation that may or may not result in recovery, In re Blumenberg, 263 B.R. 704 (Bankr. E.D.N.Y. 2001). In short, determining whether an asset is burdensome to the estate requires the bankruptcy court to look at the big picture and consider an asset's value, encumbrances, and options (or lack thereof) for liquidation. If, overall, abandoning the asset will bring about a better result for creditors than administering it, the asset may be abandoned. We find no error of law in the bankruptcy court's determinations below.

Second, a bankruptcy judge must make findings of fact about the contested asset that will help it determine if the asset meets the definition above. This might include the asset's market value, liquidity, salability, or encumbrances. We review these purely factual findings for clear error. U.S. Bank Nat'l Assoc., 138 S.Ct. at 966. Here, the bankruptcy court found the following basic facts:

1. It was uncertain whether the talc claims were property of the estate or whether they were abandoned in 2007.

2. The talc claims were, at the time, subject to litigation before the arbitration tribunal.

3. The issue of ownership of the talc claims is complex.

4. It would require expensive litigation to determine whether the estate owned the talc claims.

5. If the Trustee had not abandoned the talc claims, she would have had to either initiate or defend litigation about the ownership of the talc claims.

6. It was uncertain whether the Trustee would be successful in litigation to determine the ownership status of the talc claims.

7. The talc claims were not easily administrable because they were not liquid claims.

8. TEG's claim (Claim 1-1) is not clearly objectionable, but instead has some basis for it.

The bankruptcy court did not clearly err by making any of these findings. Id. at 966 (defining a clear error review as review "with a serious thumb on the scale for the bankruptcy court").

The Slovak Republic argues that the fifth and seventh findings are incorrect because the Trustee could have easily administered the talc claims and avoided litigation by selling them to the Slovak Republic via quitclaim deed. But, in a case like this one, a quitclaim deed does not guarantee a litigation-free transaction. Although a quitclaim deed often protects the grantor from liability, it does not protect the grantor from being forced to participate in litigation between third parties arguing over the ownership of the quitclaimed asset. At the time the bankruptcy court made its findings, the talc claims were the focus of the international arbitration and the subject of aggressive and conflicting complex claims. It was reasonable for the bankruptcy court to find that neither the Slovak Republic nor EuroGas II was going to rest until the ownership of the talc claims was finally decided. It was also reasonable for the bankruptcy court to find that the Trustee may be obligated to appear on behalf of the estate in the arbitration or other litigation between the Slovak Republic, EuroGas I, and/or EuroGas II if she attempted to sell the estate's interests in the talc claims via quitclaim. Thus, it was not clear error for the bankruptcy court to find that, if the Trustee had not abandoned the talc claims, she would have had to participate in expensive litigation to determine the ownership of the claims and that the talc claims were difficult to administer.

***6** Third, a bankruptcy judge must determine whether its findings of fact satisfy the legal test for whether an asset is "burdensome" or "inconsequential," a mixed question of fact and law. The standard of review that applies to mixed questions depends on the nature of the question. Mixed questions that require courts to "expound on the law" are reviewed de novo, whereas questions that require courts to immerse themselves in "case-specific factual issues" and "marshal and weigh evidence" are reviewed for clear error. U.S. Bank Nat'l Assoc., 138 S.Ct. at 967. The mixed question in this case required the bankruptcy judge to apply the facts it found about the talc claims to its definitions of "burdensome" and "inconsequential," primarily factual work. Accordingly, we review that decision for clear error. Id. at 967–69.

It was not clear error for the bankruptcy court to conclude that the talc claims were burdensome. As mentioned above, a burdensome analysis takes into account all of the

hurdles involved in administering an asset to determine if the expected cost of administering it would exceed the expected benefit. In re K.C. Mach. & Tool Co., 816 F.2d 238, 246 (6th Cir. 1987). If, after considering an asset's value, encumbrances, and options for liquidation, it seems that abandonment will bring more money into the estate than administering the asset, then the asset may be abandoned.

The Trustee could not sell or liquidate the talc claims without becoming embroiled in expensive litigation, and the estate had no resources with which to pursue the talc claims. The greatest value we can place on the talc claims on this record is $250,000 because that is what the Slovak Republic, the only bidder, offered to pay for them. At oral argument, counsel for EuroGas II stated that a win against the Slovak Republic in the arbitration proceedings would result in a damages award in the "hundreds of millions of dollars," but statements by counsel at oral argument are not evidence. Versarge v. Twp. of Clinton N.J., 984 F.2d 1359, 1370 (3d Cir. 1993) ("[U]nsubstantiated arguments made in briefs or at oral argument are not evidence to be considered by this Court."); British Airways Bd. v. Boeing Co., 585 F.2d 946, 952 (9th Cir. 1978), cert. denied, 440 U.S. 981, 99 S.Ct. 1790, 60 L.Ed.2d 241 (1979) ("[L]egal memoranda and oral argument are not evidence."). Thus, it is defensible to conclude that abandoning the talc claims was the most lucrative option for creditors. While pursuing title to or attempting to sell the talc claims would have cost the estate litigation expenses, abandoning the talc claims awarded the estate $250,000 and relieved the estate of a $113 million claim against it. [4] Therefore, if sold, the talc claims were worth perhaps $250,000, but abandonment of the talc claims resulted in a dismissal of a claim to the bankruptcy assets of approximately $113 million plus receipt of $250,000 to the estate from EuroGas II. The bankruptcy court did not commit clear error by finding that the talc claims were burdensome to the estate because the cost of administering the talc claims exceeded their value.

Fourth, if the factual predicate exists for abandonment (if the asset at issue is burdensome or of inconsequential value to the estate), the bankruptcy court must decide whether to approve the abandonment. We review that decision for an abuse of discretion. See In re Interpictures Inc., 217 F.3d 74, 76 (2d Cir. 2000). However, the Slovak Republic has not argued that the bankruptcy court erred in this ultimate decision. It contests only that the talc claims were neither burdensome nor of inconsequential value, which we have already rejected.

III. CONCLUSION

***7** For the foregoing reasons, we deny EuroGas II's motion to dismiss for lack of standing and vacate the BAP's order of dismissal. We remand the case to the BAP with instructions to affirm the bankruptcy court's order.

BACHARACH, J., concurring in the order and judgment. This appeal grew out of the bankruptcy court's approval of the trustee's agreement with EuroGas II, which disposed of claims over talc deposits in the Slovak Republic. The Slovak Republic appealed the bankruptcy court's ruling to the Bankruptcy Appellate Panel, which concluded that (1) the Slovak Republic lacked prudential standing to challenge the bankruptcy court's approval of the agreement and (2) the bankruptcy court did not abuse its discretion when approving the trustee's abandonment of the talc claims. The majority declines to decide the issue of prudential standing but upholds the bankruptcy court's approval of the abandonment. I agree with the well-reasoned order and judgment and write separately only to address the Slovak Republic's prudential standing to appeal.

Prudential standing turns on whether the Slovak Republic was "aggrieved" by the bankruptcy court's order. In my view, the Slovak Republic has adequately alleged facts showing aggrievement from the bankruptcy court's order.

* * *

Under the agreement leading to this appeal, the trustee abandoned the talc claims in exchange for EuroGas II's payment of $250,000 and the withdrawal of a creditor's claim against the estate for $113 million. The Slovak Republic, a creditor of the bankruptcy estate, alleges that the trustee could have obtained greater value for the estate by disposing of the talc claims through competitive bidding. The threshold issue is whether this allegation satisfies the Slovak Republic's burden to establish prudential standing to appeal. [1]

In bankruptcy appeals, our requirements for standing exceed those of Article III. *In re C.W. Mining Co.*, 636

F.3d 1257, 1260 n.5 (10th Cir. 2011). In these appeals, the appellant must demonstrate that it is aggrieved by the bankruptcy court's order. *In re Am. Ready Mix, Inc.*, 14 F.3d 1497, 1500 (10th Cir. 1994); *see Holmes v. Silver Wings Aviation, Inc.*, 881 F.2d 939, 940 (10th Cir. 1989) (adopting the "person aggrieved" standard). An appellant is considered "aggrieved" if its rights are impaired. *In re Am. Ready Mix*, 14 F.3d at 1500.

In this appeal, we must consider this standard in light of the Slovak Republic's status as an unsecured creditor. Unsecured creditors generally have a "direct pecuniary interest in a bankruptcy court's order transferring assets of the estate." *In re P.R.T.C., Inc.*, 177 F.3d 774, 778 (9th Cir. 1999); *see also Kane v. Johns-Manville Corp.*, 843 F.2d 636, 642 (2d Cir. 1988) ("As a general rule, creditors have standing to appeal orders of the bankruptcy court disposing of property of the estate because such orders directly affect the creditors' ability to receive payment of their claims."). Despite this general rule, the Bankruptcy Appellate Panel concluded that the Slovak Republic lacked a direct pecuniary interest in the order because the agreement had benefited unsecured creditors.

***8** In considering this conclusion, we engage in de novo review. *Opportunity Fin., LLC v. Kelley*, 822 F.3d 451, 457 (8th Cir. 2016). For this review, we assume that the Slovak Republic's relevant allegations are true and construe them in the Slovak Republic's favor. *See Fortune Nat. Res. Corp. v. U.S. Dep't of Interior*, 806 F.3d 363, 366 (5th Cir. 2015) (stating that under the aggrievement test for prudential standing, the court must accept the appellant's material allegations as true and construe them favorably toward the appellant).

Applying de novo review, I would conclude that the Slovak Republic has adequately alleged aggrievement from the bankruptcy court's order. The Bankruptcy Appellate Panel reached a contrary conclusion by failing to credit the Slovak Republic's allegations.

In both bankruptcy court and on appeal to the Bankruptcy Appellate Panel, the Slovak Republic alleged

- a valuation of the talc claims beyond what EuroGas II had paid for them,
- the trustee's failure to maximize the value of the talc claims by refusing to sell them through competitive bidding, and
- the invalidity of the $113 million claim against the estate.

If these allegations are credited, a court could reasonably make two factual findings:

1. The trustee could have obtained more money for the talc claims than she did.
2. If the trustee had obtained more money for the talc claims than she did, the Slovak Republic would have obtained more money for its unsecured claim.

If a court made these findings, approval of the agreement would have harmed the Slovak Republic because the estate could otherwise have obtained more money for unsecured creditors through the use of competitive bidding. The actual agreement generated $250,000 for the estate and the withdrawal of a substantial claim against the estate. But the Slovak Republic alleges that it and EuroGas II have placed a far greater value on the talc claims. Even EuroGas II appears to agree, conceding that it values the talc deposits in the hundreds of millions of dollars. [2]

If the Slovak Republic were to prove its allegations, a fact-finder could ultimately conclude that the estate's unsecured creditors would have obtained more money through competitive bidding. *See In re DCA Dev. Corp.*, 489 F.2d 43, 46 n.10 (1st Cir. 1973) (holding that an unsecured creditor satisfied the aggrievement test for prudential standing because its allegations indicated that the trustee might have obtained greater value for the assets). The Slovak Republic has adequately alleged aggrievement from the challenged order, and the bankruptcy court's ultimate assessment on the merits does not preclude appellate standing. *See In re DBSD N. Am., Inc.*, 634 F.3d 79, 89–90 (2d Cir. 2011) (concluding that a creditor's allegations about the value of its claim triggered appellate standing under the "aggrievement" test even though the bankruptcy court ultimately regarded the claim as worthless). Thus, the Bankruptcy Appellate Panel should not have dismissed the appeal for lack of prudential standing.

All Citations

--- Fed.Appx. ----, 2019 WL 103891

Footnotes

* This order and judgment is not binding precedent, except under the doctrines of law of the case, res judicata, and collateral estoppel. It may be cited, however, for its persuasive value consistent with Fed. R. App. P. 32.1 and 10th Cir. R. 32.1.

1 Along the way, the Slovakian Supreme Court weighed in, determining that efforts to revoke certain of the Talc Mining Rights violated the laws of the Slovak Republic, but notwithstanding those rulings the Slovak Republic has refused to reinstate the revoked mineral rights.

2 We do not address this abandonment argument.

3 The Slovak Republic argues that the BAP exceeded its jurisdiction by addressing the merits after dismissing the appeal for lack of prudential standing. Because the "person aggrieved" standing is prudential and not derived from Article III, the BAP had jurisdiction to consider the merits in the alternative.

4 The Slovak Republic argues that it objected to Claim 1-1 and still believes that it is invalid. However, at the time the Trustee decided to abandon the talc claims, Claim 1-1 was valid and had to factor into the Trustee's decision-making process. Further, it was not error for the bankruptcy court here to have made a finding that "TEG's claim (Claim 1-1) is not clearly objectionable, but instead has some basis for it." (App. 450)

1 The Slovak Republic also bases prudential standing on how the order would affect arbitration proceedings. We need not consider this argument.

2 At oral argument, counsel for EuroGas II and the trustee stated that EuroGas II believed that a win against the Slovak Republic in the arbitration proceedings would result in a damages award in the "hundreds of millions of dollars."