Session Date: Saturday, May 20, 2023

Session Time: 11:00am – 12:00pm

Session Name: Judges' Roundtable Roulette

Total Minutes: 60

Total Credit Hours: 1

California Bankruptcy Forum 2023

JUDGES' ROUNDTABLE ROULETTE:

In groups of judges and other attendees, discuss selected topics related to trending bankruptcy related litigation by drawing upon your expertise, knowledge, and experience.

To elicit the participants' collective wisdom for a focused discussion, review the material on these recent trending topics below.

After group discussions, a representative from each group will share observations with attendees at large.

I. Cannabis – Are Bankruptcy Courts Finally Opening for Business?

California and numerous other states have legalized the medical and recreational use of marijuana. Marijuana, however, remains a Schedule I controlled substance under the federal Controlled Substances Act, 21 U.S.C. §§ 801-904 ("CSA"). The CSA prohibits, among other things, the manufacture, distribution, dispensing of, or possession with intent to manufacture, distribute, or dispense, a controlled substance. 21 U.S.C. § 841(a). Therefore, it is a federal crime to manufacture, distribute, or dispense, or possess with intent to manufacture, distribute, or dispense marijuana and to aid and abet the foregoing activities.

The Bankruptcy Court has historically been inaccessible to cannabis and cannabis-adjacent businesses because actual or potential breaches of the CSA were viewed as *per se* cause for dismissal. A bankruptcy filing by an individual or entity with ties to a marijuana business raises difficult issues regarding how involved a debtor may be in that business and still be permitted to seek relief under the Code.

The case law continues to evolve, and few bright line rules have emerged from decisions published to date. One principle seems implicit in the Ninth Circuit case law, however: the mere presence or "whiff" of marijuana near a bankruptcy case does not automatically prohibit a debtor from bankruptcy relief. Garvin v. Cook Investments NW, SPNWY, LLC, 922 F.3d 1031 (9th Cir. 2019) (Ninth Circuit rejected a *per se* rule that a bankruptcy case should be dismissed and affirmed confirmation of a Chapter 11 plan of a real estate holding company that formerly leased property used to grow marijuana, where the debtor's plan provided for rejection of the marijuana grower's lease and payment of all creditors' claims solely out of revenues unrelated to cannabis activities); In re Olson, Case No. 17-1168, 2018 WL989263 (9th Cir. B.A.P. Feb. 5, 2018) (Ninth Circuit BAP reversed the dismissal of the bankruptcy case of a landlord who had a cannabis dispensary as a commercial tenant, since the debtor sought to reject that lease in connection with a sale of the real property with no findings showing that a trustee would have to engage in illegal activity by continued operation of the business).

Recently, a Los Angeles based bankruptcy court presiding over a Chapter 11 case, The Hacienda Company, LLC, denied a motion to dismiss the case of a debtor in the business of wholesale manufacturing and packaging of cannabis products. In re The Hacienda Company, LLC, 647 B.R. 648 (Bankr. C.D. Cal. 2023).

Hacienda formerly operated Lowell Herb Co., a cannabis wholesaler and packager. Prior to filing for bankruptcy, the debtor sold their assets and operations to a publicly traded Canadian company in exchange for a 9.4% share of the equity in the acquiring entity. The acquiror's operation of the debtor's business was legal under Canadian law. The debtor then filed for Chapter 11 to sell the shares and distribute proceeds to creditors.

The U.S. Trustee filed an objection arguing that the case should be dismissed for "cause" under Section 1112(b) of the Bankruptcy Code. But the bankruptcy court rejected any notion that a debtor's pre-bankruptcy connection to cannabis requires dismissal. Rather, the bankruptcy court has discretion to decide whether "cause" for dismissal exists. The bankruptcy court explained:

- Liquidating a cannabis business does not necessarily violate the CSA. Hacienda no longer had any cannabis business or assets, and its operations were limited to passive

ownership of the 9.4% equity interest in a Canadian company that would be operating in compliance with Canadian law.

- Operation of a cannabis business, which is illegal under the CSA, should not result in an automatic or *per se* dismissal. The court observed that “some of the largest bankruptcy cases, like those of Pacific Gas & Electric Co. of “Erin Brockovich” *fame*, Enron Corporation, and Bernie Madoff, involve alleged or actual criminal activity.” Those cases benefitted from the Bankruptcy Code despite violations of non-bankruptcy law.
- Even where “cause” is established, the bankruptcy court can exercise its discretion under Section 1112(b)(2) of the Bankruptcy Code and permit debtors to remain in bankruptcy where the court specifically finds “unusual circumstances.” Hacienda was able to establish “unusual circumstances” because it had deliberately divested itself of involvement in the cannabis business and because “any dismissal would undermine a very realistic possibility of a substantial payment to creditors.”

The U.S. Trustee appealed the denial of the motion to dismiss. While the Hacienda decision seems to build on recent Ninth Circuit decisions allowing narrow access for cannabis-adjacent debtors to seek bankruptcy protection, the decision goes one step further by allowing a debtor that was once a direct participant in the cannabis market to remain in bankruptcy.

Questions:

1. Does the bankruptcy court's opinion in Hacienda change the landscape for struggling cannabis companies to seek Bankruptcy Court protection?

2. Is the ruling in Hacienda limited to cannabis companies that shut down their cannabis businesses prepetition and are seeking to use the Bankruptcy Code simply to liquidate their remaining assets?

3. Can the bankruptcy court's rationale in Hacienda, particularly its rejection of a zero tolerance policy and its asserted equivalence between violations of the CSA and other non-bankruptcy law, be read to support more expansive uses of the Bankruptcy Code by cannabis companies? For example:

   a. Can a cannabis company file bankruptcy to sell its assets, whether operating or not, under Section 363 of the Bankruptcy Code?

   b. Can a cannabis company utilize Chapter 11 to reorganize its affairs?

   c. Can a foreign cannabis company utilize Chapter 15 to seek U.S. recognition of a foreign insolvency proceeding?

4. What factors or pre-petition planning and actions should be utilized to make the bankruptcy court comfortable that a proposed restructuring or liquidation in bankruptcy will not contribute to continued violations of the CSA, while protecting the interests of creditors and other interest holders?

II. Gatekeeping Provisions - a Workaround of the Prohibition on Non-Debtor Exculpation Provisions?

The legality of non-debtor third party releases continues to generate significant case law that reflects a split among the Federal Courts of Appeal, but also highlights a workaround for Circuits that prohibit non-debtor exculpation provisions in a plan.

In the latest development at the Court of Appeal level, the Fifth Circuit in the case of Highland Capital Management, L.P., recently imposed strict limitations on bankruptcy courts' statutory authority to exculpate third parties from claims relating to their roles in the bankruptcy proceedings. NexPoint Advisors L.P. *et. al.* v. Highland Capital Management, L.P., 48 F.4th 419 (5th Cir. 2022), *petitions for cert. filed*, Nos. 22-631 and 22-669 (Supreme Court, January 5, 2023 and January 16, 2023).

Highland Capital's chapter 11 reorganization case was extremely litigious. The Fifth Circuit's opinion said that the former chief executive "and other creditors began to frustrate the proceedings by objecting to settlements, appealing orders, seeking writs of mandamus, interfering with [the debtor's] management, threatening employees, and canceling trades between [the debtor] and its clients." Id. at 426. The appeals court went on to quote one of the debtor's independent directors, who said that the former CEO wanted to "burn the place down." Id.

The bankruptcy court successfully mediated with the largest creditors and ultimately confirmed a reorganization plan amenable to most of the remaining creditors. Anticipating that the ousted corporate officers would file suits outside of the bankruptcy court after confirmation, the chapter 11 plan contained both exculpation provisions alongside gatekeeping provisions that allow the bankruptcy court to decide whether someone may sue participants in the bankruptcy case. The debtor's former CEO and other creditors unsuccessfully objected to the confirmation order and then sought an appeal to the Fifth Circuit. In turn, the debtor moved to dismiss the appeal as equitably moot.

First, the Fifth Circuit held that equitable mootness does not bar its review of any claim. Second, the Fifth Circuit affirmed the confirmation order in large part, but reversed only insofar as the plan exculpates certain non-debtors in violation of 11 U.S.C. § 524(e). The Fifth Circuit ruled that the exculpations were broader than the circuit's precedent permits. It struck provisions in the plan providing exculpations for anyone other than the debtor, the creditors' committee and its members for conduct within the scope of their duties, and the independent directors. However, the Fifth Circuit said that "the injunction and gatekeeping provisions are sound" and that "[c]ourts have long recognized bankruptcy courts can perform a gatekeeping function." Id. at 435, 439.

The Fifth Circuit acknowledged that its decision in Highland Capital along with its earlier decision in Pacific Lumber Co. represents a contested view of the bankruptcy court's powers: "The simple fact of the matter is that there is a circuit split concerning the effect and reach of [Section] 524(e). The Fifth Circuit explained that the Second, Third, Fourth, Sixth, Seventh, Ninth and Eleventh Circuits "allow varying degrees of limited third-party exculpations." Only

the Tenth Circuit agrees with the Fifth Circuit that Section 524(e) is a categorical bar to such exculpation.

Other circuits considering this issue have read the text of Section 524(e) to be more permissive of nondebtor exculpation. As the Ninth Circuit has explained, because Section 524(e) speaks only about "affect[ing] the liability ... on ... such debt," it could be read not to reach the claims covered by exculpation provisions, which represent liability for conduct in the bankruptcy process, rather than liability for the underlying debt. See, Blixseth v. Credit Suisse, 961 F.3d 1074, 1082-83 (9th Cir. 2020), *cert. denied*, 141 S. Ct. 1394 (2021). While the Fifth Circuit acknowledged Blixseth, lower court cases in the Ninth Circuit have generally permitted exculpation clauses in a Chapter 11 plan, which are (i) limited to parties who are fiduciaries of the estate or their professionals, (ii) temporally limited to conduct which is post-petition and pre-confirmation and/or pre-effective date, (iii) limited to conduct which does not constitute gross negligence or willful misconduct, and (iv) consistent with the principles of qualified immunity. See e.g., In re S. Edge LLC, 478 B.R. 403, 414 (D. Nev. 2012) (exculpation clause provided that no party was released from obligations under the Plan or for "willful misconduct or gross negligence."); In re Yellowstone Mountain Club, LLC, 460 B.R. 254 (Bankr. D. Mont. 2011), *aff'd sub nom*. Sumpter v. Yellowstone Mountain Club, LLC, 584 F. App'x 676 (9th Cir. 2014); In re Fraser's Boiler Service, Inc., 593 B.R. 636, 640–41 (Bankr. W.D. Wash. 2018); In re Simplot, 2007 WL 2479664, *20 (Bankr. D. Idaho 2007); In re WCI Cable, Inc., 282 B.R. 457, 476-477 (Bankr. D. Or. 2002).

The Fifth Circuit's opinion expressly notes a split of authority among the federal courts of appeals as to the meaning of Title 11 of the U.S. Code, Section 524(e), leaving an uncertain landscape for parties that wish to include exculpatory provisions or nonconsensual releases in Chapter 11 plans.

On remand, the debtor moved to modify the plan in one respect only, to define exculpated parties to be those specified by the Fifth Circuit. As they had done in the Fifth Circuit, the objectors wanted the bankruptcy judge to limit gatekeeping protection to only properly exculpated parties.

The bankruptcy court judge modified the plan only by limiting the number of exculpated parties, as the debtor sought. The bankruptcy court held "that the only thing that needs to be done in response to the Final Fifth Circuit Opinion and mandate is to change the defined term for 'Exculpated Parties.'" Aside from the exculpations, the court said that the "Fifth Circuit did not modify the Gatekeeper Provision or its applicable definition of 'Protected Parties' in any way."

Citing the Fifth Circuit several times for saying that the gatekeeping provisions were "sound," the bankruptcy court modified the plan only by defining the exculpated parties to be those specified by the Fifth Circuit. In other words, the bankruptcy court decided that gatekeeping can protect more than the limited number of parties who are properly covered by exculpation clauses in the Fifth Circuit decision. See, In re Highland Capital Management L.P., Case No. 19-34054 (Bankr. N.D. Tex. Feb. 27, 2023) [Docket No. 3671].

Questions:

1. A benefit of exculpation provisions is to protect officers and directors of Chapter 11 debtors from post-petition legal exposure — and insurers providing insurance coverage for such parties — who might otherwise expect such parties to be protected by a plan's exculpation and general release provision. How does the Fifth Circuit's opinion impact those parties?

2. Did the Fifth Circuit create uncertainty about post-petition legal exposure for officers and directors?

3. By excluding a debtor's officers and directors from the protection of exculpation provisions does that deter important stakeholders from participating in the reorganization process, or will gatekeeping provisions suffice?

4. Does the unavailability of exculpation to protect officers and directors add a level of complexity and reduce creditor recoveries in particularly litigious cases by encouraging parties who can no longer obtain exculpation to seek reserves for potential administrative claims for indemnification that would otherwise be discharged in accordance with Section 1141(d)(1)(A)?

5. Does the bankruptcy court's opinion on remand encourage the use of gatekeeping of parties who didn't even exist during the bankruptcy?

III. Nondischargeability of Corporate Debt in Subchapter V

When a plan is confirmed under Bankruptcy Code Section 1191(b), Subchapter V of Chapter 11 affords corporate debtors a broader discharge than individual debtors would receive. Bankruptcy Code Section 1192(2) of Subchapter V provides that a plan confirmed under Section 1191(b) does not discharge the debtor from debts of the kind specified in Section 523(a), making no reference to the type of debtor. Section 523(a), however, applies only to individual debtors, not entities. Bankruptcy courts are trying to decide if Section 1192(2) applies to entities or just individuals.

A significant shift in Chapter 11 jurisprudence, the case of Cantwell-Cleary Co. Inc. v. Cleary Packaging L.L.C. (In re Cleary Packaging L.L.C.), 36 F.4th 509 (4th Cir. 2022), ostensibly held that as a matter of fairness and equity, not necessarily the statutory language, Section 1192(2)'s discharge exceptions apply to both individual and entity debtors. The Fourth Circuit reasoned that "a small business debtor should not benefit from the discharge of debts incurred in circumstances of fraud, willful and malicious injury, and the other violations of public policy reflected in § 523(a)'s list of exceptions when that debtor is immune from the absolute priority rule."

Other courts, however, have refused to follow what they contend is flawed reasoning to achieve a satisfying result. For example, in the Fifth Circuit, the bankruptcy court for the Western District of Texas in Avion Industries, LLC v. GFS Indus., LLC (In re GFS Industries, LLC), 647 B.R. 337 (Bankr. W.D. Tex. 2022) recently dismissed an adversary proceeding under Federal Rule 12(b)(6), holding that "corporate debtors electing to proceed under Subchapter V of Chapter 11 are not subject to complaints to determine dischargeability pursuant to [section] 523(a)" and that section 727 is inapplicable in Subchapter V cases.

The GFS Industries Court also cited with approval four other bankruptcy court decisions holding that the section 523(a) exceptions to discharge are applicable only to individuals, not corporations in Subchapter V: Jennings v. Lapeer Aviation, Inc. (In re LaPeer Aviation, Inc.), 2022 Bankr. LEXIS 1032, 2022 WL 1110072 (Bankr. E.D. Mich. Apr. 13, 2022); Catt v. Rtech Fabrications, LLC (In re Rtech Fabrications LLC), 635 B.R. 559 (Bankr. D. Idaho 2021); Cantwell-Cleary Co., Inc., v. Cleary Packaging (In re Cleary Packaging, LLC), 630 B.R. 466 (Bankr. D. Md. 2021), which is the underlying bankruptcy case, the 4th circuit reversed; and Gaske v. Satellite Rests. Inc. (In re Satellite Rests. Inc.), 626 B.R. 871 (Bankr. D. Md. 2021).

Questions:

1. Corporate debtors proceeding under Chapter 11 historically have been immune to dischargeability actions under section 523(a). Subchapter V is merely a subchapter of the broader Chapter 11. Yet, the Cleary court relied, in part, upon similarities between 1228(a)(2), which is only applicable in Chapter 12 bankruptcy cases, and 1192(2), which is only applicable in Subchapter V cases. See, footnote 2: "There is one inconsequential difference — § 1228(a) refers to debt "of a kind specified," while § 1192(2) refers to debt "of the kind specified." Chapter 12 cases have unique considerations that are not present in a Chapter 11 case and Chapter 12's incorporation of Section 523 is "broader" than the provisions referencing it in Subchapter V. Does footnote 2 of the Cleary decision gloss over and ignore critical distinctions between Chapter 11 and Chapter 12 bankruptcies?
2. Does Cleary attempt to solve a problem based upon "fairness and equity" that is already solved by other sections of the Bankruptcy Code?
3. How would an objecting creditor establish the requisite intent for certain types of Section 523(a) allegations against a corporate debtor?
4. How do you identify the debtor's agents that an objecting creditor would pursue for these purposes?

IV. Debts for a Partner's Fraud Are Still Nondischargeable

In a unanimous decision the Supreme Court in Bartenwerfer v. Buckley, No. 21-908, 598 U.S. ___ (2023), confirmed, in an opinion authored by Justice Barrett, that the Bankruptcy Code bars the discharge by individual debtors of debts fraudulently obtained by the debtor's agent or business partner, even though the debtor was not "guilty of wrongdoing."

The debtor petitioner in the case purchased a house with her then boyfriend (ultimately her spouse), who was also her business partner, in order to remodel the house and sell it for a profit.

The debtor was not primarily involved in the project, leaving it to her partner to hire the architect, engineer, and contractors and to oversee the work. When the project was complete, the debtor and her partner sold the house to Buckley and in connection with the sale executed disclosures which proved to be false, as the house turned out to be defective.

Buckley sued in state court and won a judgment against the debtor and her partner for damages based on their misrepresentations. Both filed Chapter 7 bankruptcy petitions, and Buckley brought an adversary proceeding that alleged his claim should not be discharged based on fraud. After extensive litigation, including a remand of the case from the Ninth Circuit Bankruptcy Appellate Panel, the bankruptcy court held that the debt was nondischargeable as to the debtor's partner based on his fraudulent intent, but dischargeable as to the debtor, who lacked fraudulent intent. The Ninth Circuit Court of Appeals reversed, holding that, under the Supreme Court's pre-Bankruptcy Code decision in Strang v. Bradner, 114 U.S. 555 (1885), Buckley's claim was also nondischargeable as to the debtor based on the debtor's business partnership with the individual who actually committed the fraud.

The case before the Supreme Court turned on the interpretation of Section 523(a)(2)(A) of the Bankruptcy Code, which excepts from an individual debtor's discharge "any debt . . . to the extent obtained by false pretenses, a false representation or actual fraud." The Debtor argued that this statutory language implicitly limits non-dischargeability to debts obtained by fraud directly committed by the debtor. The court disagreed, holding that, read naturally, the passive voice in the statute "pulls the actor off the stage" — making it irrelevant that the debtor was never herself found to have acted with fraudulent intent. Thus, the debtor could not discharge Buckley's debt because it was obtained by her partner's fraud.

In Bartenwerfer the court was careful to note that state law, not Section 523(a) itself, defines the contours of liability for fraud. This guards against "liability imposed willy-nilly on hapless bystanders" because "ordinarily, a faultless individual is responsible for another's debt only when the two have a special relationship" and those individuals often have defenses to liability. In a separate concurrence, Justices Sotomayor, joined by Justice Jackson, wrote that she understands the holding to not extend Section 523(a)(2)(A) liability to "a person bearing no agency or partnership relationship to the debtor."

Questions:

1. How does one enter into a "passive" partnership arrangement with others and protect themselves if they file for bankruptcy protection against non-dischargeability of a debt incurred solely due to the fraudulent activities of a partner?

2. Under Bartenwerfer, are there any facts or circumstances where an innocent actor can be found not liable or liability can be limited to that of the guilty actor?

3. While the concurrence focuses on agency and partnership principles, can the opinion be interpreted to provide for vicarious liability for non-culpable individuals who are not agents or partners of the guilty actor?

PRODUCERS BIOS:

Richard H. Golubow, Winthrop Golubow Hollander, LLP

Richard H. Golubow is a founder and the managing partner of Winthrop Golubow Hollander, LLP, a financial restructuring, insolvency, and bankruptcy law firm headquartered in Newport Beach, California, and with offices in New York. Richard devotes his practice to and has extensive experience in the areas of financial restructuring, insolvency law, complex bankruptcy and business reorganizations and related litigation, liquidations, out-of-court workouts, acquisitions and sales of distressed assets, Uniform Commercial Code Article 9 foreclosure sales, general assignments for the benefit of creditors, and receiverships. Richard has a diverse client base that includes representation of debtors, creditors, creditor committees, trustees, assignees for the benefit of creditors, receivers and asset purchasers in a wide range of industries. He frequently lectures on or serves as moderator for bankruptcy and bankruptcy alternative topics for local, national and international organizations. Richard has published numerous articles on bankruptcy related topics and is the author of Local Bankruptcy Rules: California (C.D. Cal.), an extensive Practice Note summarizing selected local rules of the US Bankruptcy Court for the Central District of California, published by Thomson Reuters. Richard has been frequently honored or recognized as the recipient of bankruptcy or financial restructuring attorney of the year awards by several leading international organizations and financial publications, including a 2017 "Deal of the Year" Award by M&A Advisor. Since 2004, he holds an "AV® Preeminent™" Peer Rating, Martindale-Hubbell's highest level of professional excellence based upon peer recognition for legal knowledge, communication skills, and ethical standards. He is a perennial selection as a Southern California "Super Lawyer", including being selected a "Top 50 Orange County Super Lawyer" for 2017-2023, and is recognized by The Best Lawyers in America® for Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law. He is a member of the International Network of Boutique Law Firms (INBLF), an invitation only network of lawyers from single-discipline boutique law firms with the highest level of knowledge, experience, reputation and credentials comparable or superior to what can be found at the highest-ranking full-service law firms.

Joseph A. Zagajeski, Development Specialists, Inc.

Joseph A. Zagajeski, is a Director in DSI's San Francisco office with substantial experience covering bankruptcy and insolvency, restructuring, litigation, and forensic accounting services in and out of court. Mr. Zagajeski's experience includes advising and assisting trustees in significant Chapter 7 and 11 cases, providing services in forensic accounting and expert witness/report matters, and involvement in numerous engagements as financial advisor to debtors, trustees and committees. Notable assignments include Comcar Industries, Inc., Dillingham Construction, Direct Lending Investments, LLC, Highland Capital Management, LP, Howrey LLP, Matheson Flight Extenders, Inc. Matheson Postal Services, Inc., Matheson Trucking, Inc., Pearl Automation, Inc., Pacific Thomas Corporation, Sedgwick LLP and Stion

Corporation. Additionally, Mr. Zagajeski has been involved in Receiverships and Assignments for the Benefit of Creditors focused on startup wind downs. Mr. Zagajeski is currently a board member of the California Receivers Forum and TMA NorCal, as well as the former President of the Bay Area Receivers Forum. Mr. Zagajeski is a Certified Fraud Examiner and also certified as a Cryptocurrency Forensic Investigator and has provided forensic services in tracking and tracing of cryptocurrency. His professional memberships include the California Bankruptcy Form, California Receivers Form, Bar Association of San Francisco and the Turnaround Management Association. Mr. Zagajeski is the former President of the CA Receivers Forum – Bay Area Chapter. Mr. Zagajeski has a B.S. from the University of California at Los Angeles.

Appendix of Cases

Cannabis – Are Bankruptcy Courts Finally Opening for Business?

In re The Hacienda Company, LLC, 647 B.R. 648 (Bankr. C.D. Cal. 2023)

Gatekeeping Provisions – a Workaround of the Prohibition on Non-Debtor Exculpation Provisions?

NexPoint Advisors L.P. v. Highland Capital Management, 48 F.4th 419 (5th Cir. 2022)

In re Highland Capital Management L.P.,
Case No. 19-34054 (Bankr. N.D. Tex. Feb. 27, 2023) [Docket No. 3671]

Nondischargeability of Corporate Debt in Subchapter V

Cantwell-Cleary Co. Inc. v. Cleary Packaging L.L.C.
(In re Cleary Packaging L.L.C.), 36 F.4th 509 (4th Cir. 2022)

Avion Industries, LLC v. GFS Indus., LLC
(In re GFS Industries, LLC), 647 B.R. 337 (Bankr. W.D. Tex. 2022)

Debts for a Partner's Fraud Are Still Nondischargeable

Bartenwerfer v. Buckley, No. 21-908, 598 U.S. ___ (2023)

Cannabis – Are Bankruptcy Courts Finally Opening for Business?

In re The Hacienda Company, LLC, 647 B.R. 648 (Bankr. C.D. Cal. 2023)

647 B.R. 748
United States Bankruptcy Court, C.D. California.

IN RE: The HACIENDA COMPANY, LLC, Debtor.

Case No.: 2:22-bk-15163-NB
|
Signed January 20, 2023

Synopsis
Background: United States Trustee (UST) filed motion to dismiss Chapter 11 case of debtor that, prepetition, manufactured and packaged cannabis products before ceasing operations and transferring its value to Canadian company and selling vacant land that debtor had intended for use as cannabis cultivation center.

Holdings: The Bankruptcy Court, Neil W. Bason, J., held that:

fact that UST filed notice of appeal did not divest Bankruptcy Court of jurisdiction to issue opinion following denial of UST's motion to dismiss;

UST failed to establish "cause" to dismiss case based on any violations of Controlled Substances Act (CSA); and

unusual circumstances precluded dismissal under Bankruptcy Code's "for cause" provision.

Motion denied.

Procedural Posture(s): Motion to Convert or Dismiss Case.

Attorneys and Law Firms

***750** Russell Clementson, Los Angeles, CA, Dare Law, Kelly L. Morrison, Office of the United States Trustee, Los Angeles, CA, for U.S. Trustee.

David L. Neale, Juliet Y. Oh, Lindsey L. Smith, Levene, Neale, Bender, Yoo & Golubchik L.L.P., Los Angeles, CA, for Debtor.

OPINION ON MOTION TO DISMISS CANNABIS-RELATED CASE

Neil W. Bason, United States Bankruptcy Judge

This Bankruptcy Court has already issued an order (docket no. 71) denying the motion of the United States Trustee's ("UST") to dismiss this case (docket no. 53, the "MTD"). This Opinion memorializes and further explains this Court's reasoning. [1]

1 Unless the context suggests otherwise, a "chapter" or "section" ("§") refers to the United States Bankruptcy Code, 11 U.S.C. § 101 et seq. (the "Code"), a "Rule" means the Federal Rules of Bankruptcy Procedure or other federal or local rule, and other terms have the meanings provided in the Code, Rules, and the parties' filed papers.

1. BACKGROUND

The above-captioned Debtor was in the business of wholesale manufacturing and packaging cannabis products under the "Lowell Herb Co." brand, a/k/a "Lowell Farms," and it ceased operations on February 25, 2021. At one time, Debtor owned land that was intended for use as a cannabis cultivation center, but Debtor did not achieve this goal and the vacant land was sold in 2020 to pay creditors.

After Debtor ceased operations, it transferred its value to a publicly traded Canadian company – allegedly by structuring the sale as one of intellectual property, not the sale of an operating cannabis business. The acquirer's sole business is cannabis growth and sales, which apparently are legal under Canadian law. In return, Debtor received a roughly 9.4% share of the equity shares of the acquiring entity. The acquiring entity changed its name to Lowell Farms, Inc.

On September 21, 2022, Debtor filed this bankruptcy case. In Debtor's initial status report, Debtor stated that it intended "to propose a plan of reorganization that provides for Debtor to sell off the shares of [Lowell Farms, Inc. that] it owns in an orderly fashion and use the proceeds from the stock to pay creditors [or] ... Debtor may elect to distribute the shares it owns to its creditors directly." At oral argument, Debtor's counsel elaborated that the stock of Lowell Farms, Inc. is thinly traded and therefore, to avoid flooding the market and depressing the return to creditors, "we're talking about selling it off in chunks [over time] ...." Tr. 12/20/23 (docket no. 76), p. 16:19.

2. JURISDICTION, AUTHORITY AND VENUE

This Bankruptcy Court has jurisdiction to decide the MTD, and venue is proper, under 28 U.S.C. §§ 1334 and 1408. This is a "core" proceeding in which this Bankruptcy Court has the authority to

enter a final judgment or order under 28 U.S.C. § 157(b)(2)(A) and (O). *See also* *Stern v. Marshall*, 564 U.S. 462, 131 S. Ct. 2594, 180 L.Ed.2d 475 (2011). [2]

2 Although the UST has filed a notice of appeal, that does not divest this Bankruptcy Court of jurisdiction to issue this Opinion for two alternative reasons. First, so far as this Bankruptcy Court is aware, no appellate court has granted the UST's motion for leave to appeal (docket no. 90). *See* *In re Rains*, 428 F.3d 893, 903-904 (9th Cir. 2005) ("if the order at issue is interlocutory, any appeal ... would not transfer jurisdiction to an appellate court") (citations omitted); *In re Bertain*, 215 B.R. 438 (9th Cir. BAP 1997) ("The denial of a motion to dismiss is an interlocutory order") (cleaned up; citations omitted). Second, this Opinion does not alter or expand any prior rulings, and instead merely provides further explanation, as anticipated on the record at the above-captioned hearing. *See* *Rains*, 428 F.3d at 904 (other exceptions to rule that notice of appeal divests lower court of jurisdiction).

*751 3. DISCUSSION

a. Legal standards

As the parties acknowledge, the burden of establishing "cause" for dismissal under § 1112(b) rests with the party seeking dismissal. *See* *In re Rosenblum*, 608 B.R. 529, 536 (Bankr. D. Nev. 2019). The movant must show such cause by "a preponderance of the evidence." *In re Woodbrook Assocs*., 19 F.3d 312, 317 (7th Cir. 1994).

If the movant establishes that "cause" exists under § 1112(b)(1), then the opponent can still prevent conversion or dismissal under § 1112(b)(2) if (1) the court "finds and specifically identifies unusual circumstances establishing" that conversion or dismissal is "not in the best interests of creditors"; (2) the opponent shows that "there is a reasonable likelihood" of confirming a plan in a reasonable amount of time; (3) the opponent establishes that the grounds for conversion or dismissal include an act or omission of the debtor for which there is a "reasonable justification"; and (4) the opponent establishes that the act or omission can be "cured within a reasonable time." *See* *Rosenblum*, 608 B.R. at 536-37 (summarizing § 1112(b)(2)).

If the debtor cannot satisfy the "unusual circumstances" elements under § 1112(b)(2), then the bankruptcy court must choose "between conversion or dismissal based on the best interests of the creditors and the estate." *In re Nelson*, 343 B.R. 671, 675 (9th Cir. BAP 2006) (citation and internal quotation marks omitted).

b. Violations of nonbankruptcy law, generally

A violation of nonbankruptcy law is not expressly listed as "cause" for dismissal under § 1112(b) (1) & (4), but compliance with applicable nonbankruptcy law generally is required both by statute

(*e.g.,* 28 U.S.C. § 959) and under the authorities cited by both parties, so it appears to be undisputed that violations of nonbankruptcy law *can* be cause for dismissal. That said, there are many remedies for any debtor's violations of any law, rule, or procedure, and dismissal is one of the more extreme remedies.

There are several alternative reasons why violations of nonbankruptcy law might establish cause for dismissal. First, such violations might establish a lack of "good faith" sufficient to warrant dismissal. *See, e.g., In re Arenas*, 535 B.R. 845 (10th Cir. BAP 2015) (debtors' marijuana business, while legal under state law, was illegal under federal law, and thus the debtors could not propose a confirmable plan in good faith). *See generally In re Leavitt,* 171 F.3d 1219, 1224 (9th Cir. 1999) ("cause" for dismissal not defined by the Code, but can include "bad faith"/lack of "good faith"); *Rosenblum,* 608 B.R. at 537 (listing common considerations in assessing good faith).

Second, violations of nonbankruptcy law might constitute "gross mismanagement" ***752** of the estate, within the meaning of § 1112(b)(4)(B), because violations of nonbankruptcy law might expose the estate to financial losses and criminal sanctions, and violating the law might constitute "mismanagement" *per se*. *See, e.g., In re Rent-Rite Super Kegs West Ltd.,* 484 B.R. 799, 809 (Bankr. D. Colo. 2012) (Debtor's decision to continue leasing warehouse space to tenants engaged in the business of growing marijuana exposed Debtor to criminal liability and the risk of forfeiture which amounted to gross mismanagement).

In addition, violations of nonbankruptcy law might warrant dismissal under general principles applicable to a bankruptcy court as a court of equity, pursuant to bankruptcy judges' oath of office to uphold the law, or on other theories. *See, e.g., In* re *Johnson*, 532 B.R. 53, 56-58 (Bankr. W.D. Mich. 2015) (suggesting that authorizing debtor to continue generating income from marijuana operations appears inconsistent with judicial oath to uphold the law, but concluding that Debtor could remain in bankruptcy and avoid dismissal of his case if he ceased marijuana operations). *See also* MTD (docket no. 53) pp. 8:18-17:11; Opp. (docket no. 59) pp. 3:6-19:26; *and* Reply (docket no. 63) pp. 7:22-11:14 (discussing authorities).

But the authorities cited by the parties also appear to reflect some degree of discretion. Ongoing postpetition violations are far more problematic than prepetition violations; and although indirect connections with illegal activity might violate nonbankruptcy law, the degree of connection appears to be important to deciding whether to dismiss the case. *See e.g., In re Burton*, 610 B.R. 633, 637-638 (9th Cir. BAP 2020) (affirming dismissal as within bankruptcy court's discretion, but holding that "the mere presence of marijuana near a bankruptcy case does not automatically prohibit a debtor from bankruptcy relief," so a "bankruptcy court must be explicit in articulating its legal and factual bases for dismissal in cases involving marijuana") (citations omitted); *and see also Garvin v. Cook Investments NW, SPNWY, LLC,* 922 F.3d 1031, 1036 (9th Cir. 2019) (bankruptcy judge is not an "ombudsman without portfolio, gratuitously seeking out

'illegalities' ..., a result that would be "inimical to the basic function of bankruptcy judges ...") (footnote, citations, and internal quotation marks omitted).

c. The Controlled Substances Act, 21 U.S.C. § 801 et seq. (the "CSA")

The UST has not established any ongoing violation of the CSA by Debtor, as distinguished from any prepetition violations, either (i) by any connection to distributing cannabis or (ii) by stock ownership in a cannabis-related enterprise. Nor has the UST established that, if a chapter 11 trustee were appointed or if this case were to be converted to a chapter 7 liquidation, any trustee would have to engage in a violation of the CSA.

i. No ongoing distribution of cannabis

True, the CSA covers conspiracies with intent to distribute cannabis, and one way to characterize the facts might be that Debtor is effectively conspiring to continue carrying on its California-based cannabis business indirectly, through its ownership interest in a Canadian company operating under Debtor's former name. *See* 21 U.S.C. §§ 846 (conspiracy) *and* 856(a) (illegal to "control any place" or "profit from" a place used to manufacture, store, distribute, or use cannabis), *and* MTD p. 8:1-8. Alternatively, even if (as this Bankruptcy Court finds and concludes) Debtor is *not* effectively carrying on its prepetition cannabis business indirectly, Debtor did structure its own liquidation in a manner designed ***753** to maximize the value derived from its connection with cannabis, which might be characterized as an indirect way to "profit from" the cannabis business.

On the other hand, this interpretation of section 856(a) of the CSA goes too far. Debtor's passive ownership of stock, with intent to liquidate that stock to pay creditors, will *terminate* any connection with cannabis. This appears to be the opposite of an intent to profit from an ongoing scheme to distribute cannabis, at least if Debtor does not maintain its investment in Lowell Farms, Inc. for too long a period of time (which is an issue that can be addressed in connection with confirmation of any chapter 11 plan). Therefore, the UST has not established a violation of section 856(a) of the CSA.

ii. No future investment of profits from cannabis

Similarly, although the UST has shown that Debtor's prepetition receipt of stock in its acquiring entity probably violated section 854 of the CSA, the UST has not established a likelihood of any postpetition violation from use or investment of cannabis proceeds. Section 854 of the CSA makes it illegal for a "person who has received any income derived, directly or indirectly, from [a relevant violation of the CSA]" to "use or invest, directly or indirectly, any part of such income, or the

proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise [engaged in or affecting interstate commerce]." *See* MTD p. 11:21-28 at n. 5 (quoting statute). Debtor does not propose, postpetition, to use any of its remaining assets to "invest" in any enterprise (cannabis-related or otherwise). Instead, Debtor proposes to sell the stock and distribute the resulting cash to creditors, or else transfer the stock directly to creditors.

iii. No showing that a future trustee would have to violate the CSA

The UST raises the specter that any future bankruptcy trustee would have to engage in illegal activity. But the UST does not explain how a trustee would have to violate the CSA or any other law.

For example, even if Debtor still had possession of any cannabis or marijuana products (which it does not), a trustee could "ask[ ] the responsible federal authorities to dispose of the estate's marijuana" and then fulfill the trustee's statutory duty to "liquidat[e] other estate property for distribution to creditors in accordance with the priorities of [§] 726." Steven J. Boyajian, Just Say No to Drugs? Creditors Not Getting a Fair Shake When Marijuana-Related Cases are Dismissed, 36 Am. Bankr. Inst. J. 24, 75 & n. 21 (Sept. 2017).

Moreover, it is not a foregone conclusion that the rights of any federal governmental unit to seize assets would supersede creditors' rights. *See id.* at 75 (text accompanying nn. 28-32). Therefore, not only has the UST failed to show that a future trustee would have to violate the CSA but, to the contrary, it appears that any future trustee probably might have a duty to administer assets rather than simply turn them over to federal authorities.

In addition, if any future trustee were concerned about any of these issues, the trustee could seek declaratory relief or other protections to assure compliance with the law and protection from liability. Alternatively, the trustee could always seek dismissal of this case at that point.

For all of the foregoing reasons, the UST has not established any ongoing violation of the CSA, nor has the UST established that any future trustee would have to violate the CSA. The lack of any demonstrated illegality, now or in the foreseeable ***754** future, is one ground for denial of the MTD.[3]

3 To be clear, Debtor's apparent ownership of over 9% of the stock of a cannabis business puts it in uncomfortably close proximity to the cannabis industry. Perhaps, if all the facts and circumstances were known to this Bankruptcy Court, and if this Bankruptcy Court were to engage in independent research beyond the authorities cited by the parties, Debtor's

> proposed liquidation actually would be a violation of the CSA or some other criminal statute. But this Bankruptcy Court has not been asked to render any summary judgment as to purported violations of criminal law, and this Bankruptcy Court's rulings above should not be interpreted as any such summary judgment. Rather, on the present record and solely for purposes of the UST's MTD, no violation of the CSA has been established.

d. Alternatively, Congress did not adopt a "zero tolerance" policy under § 1112(b) for any illegality

Supposing for the sake of discussion that the UST could establish a violation of the CSA (which it has not done), that it not enough. Congress did not adopt a "zero tolerance" policy that requires dismissal of any bankruptcy case involving violation of the CSA (or other activity that might be proven to be illegal). *See Burton*, 610 B.R. at 637 (no per se rule requiring dismissal when marijuana is present).

True, Congress has enacted the CSA and this Bankruptcy Court's duty is to follow Congressional directives. On the other hand, Congress has not specified what should be the *bankruptcy-specific* remedy for any violation of the CSA.

Congress could have included within the examples of "cause" in § 1112(b)(4) a violation of the CSA, or any other nonbankruptcy laws, but it chose not to do so. This implies that violations of nonbankruptcy laws do not *necessarily* constitute cause for dismissal or conversion.

In addition, such a broad reading of "cause" for dismissal could be extremely disruptive in other cases before this Bankruptcy Court, perhaps even the vast majority of all bankruptcy cases. *See, e.g., In re CWNevada LLC*, 602 B.R. 717, 728 n. 25 (Bankr. D. Nev. 2019) ("bankruptcy courts have a long history of considering cases whose activities and operations have included past, present and possibly ongoing violations of applicable non-bankruptcy, civil and criminal laws") (citing examples); Hon. Keith M. Lundin (Ret.), Up in Smoke, Bankruptcy Workshop, Season 2, Episode 3, available at https://lundin on chapter13.com/Content/WorkshopVideos (last visited on January 18, 2023) (noting bankruptcy courts' and trustees' statutory mandate to administer assets, and extensive history of doing so notwithstanding some connection to illegal activity).

Dismissing every case that had a connection with illegal activity would be contrary to Congress' directives under the Bankruptcy Code. Consider what would happen if the doors of the bankruptcy courts were closed to any debtor who had crossed the line into illegal activity prepetition, and were attempting to wind up that activity postpetition.

Some of the largest business bankruptcy cases, like those of Pacific Gas & Electric Co. of "Erin Brockovich" *fame*, Enron Corporation, and Bernie Madoff, involve alleged or actual criminal activity. Should those cases have been dismissed? How about cases involving sexual

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

abuse? *See CWNevada,* 602 B.R. at 728 n. 25 (citing, *inter alia,* NCR Staff, Catholic Diocese and Orders that Filed for Bankruptcy and Other Major Settlements, National Catholic Reporter (2018), https://www.ncronline.org/news/catholic-dioceses-and-orders-filed-bankruptcy-and-other-major-settlements (last visited on January 18, 2023) (listing numerous bankruptcy proceedings ***755** to address sexual abuse claims, from July 6, 2004 through approximately February 28, 2018)).

On a smaller scale, this Bankruptcy Court takes judicial notice that many small business bankruptcies involve restaurants or small apartment buildings, and most of those businesses have at least some ongoing level of violations of health and safety regulations. When dealing with food and shelter, although it is important to strive for perfection, realistically that goal can be extremely difficult to achieve.

Likewise, many individual debtors have crossed the line into illegality in ways both large and small, from engaging in criminal gang activity to failing to pay taxes or parking fines. This Bankruptcy Court takes judicial notice that individuals who are struggling financially may have difficulty paying parking fines, for example, and there are societal debates about the criminalization of nonpayment of such fines, so barring such a debtor from bankruptcy would not be a step to take lightly.

If all of the foregoing examples were sufficient "cause" for mandatory dismissal, this Bankruptcy Court might have to dismiss most bankruptcy cases. That would harm the constituencies that Congress attempted to protect using all of the tools of the Bankruptcy Code, including creditors, debtors, employees of debtors, and local governments and communities that depend on debtors' ability to reorganize their finances and resume making contributions to commerce and society.

For example, the automatic stay of § 362(a) protects creditors from a "race to collect": absent that stay the assets go to anyone who is able to seize them before other creditors. Insiders or other favored creditors might have an advantage in doing so, contrary to Congress attempts to prevent such favoritism. *See, e.g.,* § 547(b)(4) (longer "look back" period for preference recipients who are insiders).

In addition, an orderly liquidation in bankruptcy typically maximizes the value of a debtor's assets. Bankruptcy can preserve going concern value, or can authorize a sale of assets free and clear of liens and other interests, thereby obtaining higher bids than outside of bankruptcy. *See, e.g.,* §§ 363(f) *and* 1129(b)(2)(A)(ii), *and see also In re Olson,* 2018 WL 989263 at *7 (9th Cir. BAP Feb. 5, 2018) (Tighe, J., concurring) (noting the usefulness of sales free and clear, even in cases connected to marijuana).

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

In addition, dismissal of bankruptcy cases would shield recipients of avoidable transfers (*e.g.,* §§ 547, 548) and persons whose misdeeds might only come to light in the bankruptcy forum, with all of its mandated disclosures and investigative tools. *See, e.g.,* Rules 1007 & 2004; *see also* Boyajian, Just Say No to Drugs?, *supra,* 36 Am. Bankr. Inst. J. 24 at 75 (text accompanying nn. 22-27) (arguing that dismissal of involuntary chapter 7 petition allowed "the alleged debtor to use its own federally proscribed conduct [running a marijuana business] as a shield to protect it from the collection efforts of creditors holding seemingly undisputed claims"). This Bankruptcy Court doubts that Congress intended to shield recipients of avoidable transfers, and wrongdoers, by mandating dismissal of any bankruptcy case that might be connected to violations of criminal law.

In fact, in many situations the victims of illegal activity are the persons who might be most severely harmed by dismissal of any bankruptcy case. This is true whether that illegal activity involves releasing carcinogens into the water supply, financial fraud, being a "slumlord," causing food poisoning, abusing employees, child sexual abuse, or other criminal activity. The victims ***756** may be the biggest creditors, or those with the most to lose.

One other type of creditor who might well be harmed by any mandated dismissal of any case connected to illegal activity is any government agency charged with enforcing the law, such as the Department of Justice, which encompasses the Office of the UST itself. Such agencies' funding, and their ability to continue policing against criminal activity, might depend in part on the preservation and recovery of assets, including through bankruptcy.

For all of these reasons, this Bankruptcy Court does not interpret Congress' mandate that this Bankruptcy Court "shall" dismiss or convert a bankruptcy case for "cause" under § 1112(b) to mean that any violation of criminal law *requires* dismissal. Rather, this Court interprets the statute as giving discretion to determine whether dismissal is warranted based on all the facts and circumstances. *See generally Burton*, 610 B.R. 633, 640 *and passim* (review of various authorities, and referring to bankruptcy courts' "broad discretion in deciding whether to dismiss a case").

Nor does this Bankruptcy Court interpret the UST's MTD to advocate for such an extreme position. *Cf.* Clifford J. White III and John Sheahan, Why Marijuana Assets May Not Be Administered In Bankruptcy, 36 Am. Bankr. Inst. J. 34, 34-35 (Dec. 2017) (contrasting bankruptcy cases "in which the criminal activity has already been terminated and the principal concern of the bankruptcy court is to resolve competing claims by victims for compensation" from a case involving "a company that is not only continuing in its business, but even seeking the affirmative assistance of the bankruptcy court in order to ... facilitate its violations of the law going forward") (the authors are listed, respectively, as the director of the Executive Office for U.S. Trustees and as a trial attorney in the Office of the General Counsel).

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

In sum, this Bankruptcy Court interprets both § 1112(b) and the UST's MTD as adopting a middle ground, under which this Bankruptcy Court must exercise its discretion to determine whether, given all of the facts and circumstances, a debtor's connection to cannabis profits and any past or future investment in cannabis enterprises warrants dismissal of this bankruptcy case. Under this standard, the UST has not met its burden to establish sufficient cause for dismissal, for the reasons stated above, including (i) Debtor's indirect connection with any violation of the CSA (assuming, contrary to this Court's analysis in the prior section of this Opinion, that such a violation exists), (ii) Debtor's intent to liquidate its assets and pay creditors, and (iii) the benefits of a bankruptcy case for all parties in interest, including creditors.

e. Alternatively, the "unusual circumstances" exception applies

Congress has provided that even when there is "cause" to dismiss or convert a case, this Bankruptcy Court must not to do so under the "unusual circumstances" test described above. *See* § 1112(b)(2). The elements of this test have been satisfied, at least in the absence of evidence that prosecutors intend to single out Debtor for particularly harsh treatment that would undermine any ability to pay creditors and otherwise make appropriate use of the bankruptcy system.

Specifically, the unusual circumstances in this case are as follows. First, Debtor has divested itself, prepetition, of any direct involvement in the cannabis business. Second, unlike most dismissals by this Court, which generally involve situations such as a pending foreclosure of fully-encumbered ***757** property and no realistic possibility of a distribution to unsecured creditors, in this case any dismissal would undermine a very realistic possibility of a substantial payment to creditors. That successful outcome appears to be very likely because the only thing for Debtor to do is to sell its stock in the Canadian company, which appears to be legal and feasible under Canadian law, and then to use the proceeds to pay creditors; or alternatively to distribute the stock to creditors.

These facts also establish the other elements of the "unusual circumstances" test: conversion or dismissal is not in the best interests of creditors; there is a reasonable likelihood of confirming a plan in a reasonable amount of time; even if Debtor's acts and omissions in seeking to divest itself of its assets and pay creditors somehow violated the CSA or other law, and would otherwise mandate dismissal, Debtor's attempt to maximize value and pay creditors establishes a "reasonable justification" for such acts and omissions; and, so long as Debtor's process of selling or distributing its stock in the Canadian company does not take too long, any violation of law can be "cured within a reasonable time." *Rosenblum*, 608 B.R. at 536-37 (reviewing elements of § 1112(b)(2)).

In addition, this Bankruptcy Court is mindful of the fact that there are many other tools to address any wrongful or illegal conduct by any debtor in possession of the bankruptcy estate. For example, in appropriate circumstances a trustee or examiner can be appointed (§ 1104), or sanctions can be imposed. *See, e.g.,* Rule 9011. The availability of such alternatives reinforces a more flexible

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

interpretation of § 1112 as just one of many possible tools, not a tool that this Bankruptcy Court has to use regardless of the consequences.

In addition, this Bankruptcy Court notes that there are many non-bankruptcy tools that can be used to address any illegal activity. Remedies can be sought, in appropriate situations, by prosecutors, private attorneys general, class action representatives, individual plaintiffs, and others, such as local, state, and national governments, to address any violations of nonbankruptcy law in a more nuanced and targeted manner than the blunt tool of dismissing bankruptcy cases. Again, the availability of such alternatives reinforces this Bankruptcy Court's interpretation of § 1112(b) as providing some discretion: dismissal is not the only remedy.

f. No intent to condone illegal activity

To be clear, nothing in this Opinion should be interpreted as condoning illegal activity. Illegal activity can be cause for dismissal in appropriate circumstances, both as a matter of interpreting Congress' directives in § 1112(b) and, more generally, to preserve the integrity of the bankruptcy system and the bankruptcy courts that Congress has established. *See, e.g., In re Mattiace Industries, Inc.,* 76 B.R. 44, 47-48 (Bankr. E.D.N.Y. 1987) (dismissing chapter 11 bankruptcy case because debtor's continued violations of state environmental regulations endangered public health and conversion was inappropriate due to difficulties a trustee would face in managing debtor's hazardous waste site with limited estate resources)

But this Bankruptcy Court would be overstepping its role, and acting contrary to Congress' directives within the Bankruptcy Code, if it were to deny creditors, debtors, employees, equity investors, and other constituencies the benefits and protections of bankruptcy based on the facts and circumstances presented. In general this Bankruptcy Court should defer to prosecutors, and all of the other types of persons mentioned above, to use their discretion ***758** about whether and how to address any violations of nonbankruptcy law. *See Cook Investments,* 922 F.3d 1031, 1036 (rejecting "ombudsman" role of bankruptcy court). Such parties can pursue remedies in a more nuanced and targeted manner, rather than using the blunt tool of dismissal, which on the record presented is contrary to the best interests of creditors and the estate.

4. CONCLUSION

For all of the foregoing reasons, the MTD has been denied by separate order.

All Citations

647 B.R. 748, 72 Bankr.Ct.Dec. 59

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

End of Document

© 2023 Thomson Reuters. No claim to original U.S. Government Works.

Gatekeeping Provisions – a Workaround of the Prohibition on Non-Debtor Exculpation Provisions?

NexPoint Advisors L.P. v. Highland Capital Management, 48 F.4th 419 (5th Cir. 2022)

In re Highland Capital Management L.P.,
Case No. 19-34054 (Bankr. N.D. Tex. Feb. 27, 2023) [Docket No. 3671]

48 F.4th 419
United States Court of Appeals, Fifth Circuit.

In the MATTER OF: HIGHLAND CAPITAL MANAGEMENT, L.P., Debtor,
NexPoint Advisors, L.P.; Highland Capital Management Fund Advisors, L.P.; Highland Income Fund; NexPoint Strategic Opportunities Fund; Highland Global Allocation Fund; NexPoint Capital, Incorporated; James Dondero; The Dugaboy Investment Trust; Get Good Trust, Appellants,
v.
Highland Capital Management, L.P., Appellee.

No. 21-10449
|
FILED September 7, 2022

Synopsis

Background: Co-founder of Chapter 11 debtor, an investment firm that had managed billion-dollar, publicly-traded investment portfolios for nearly three decades, together with several other creditors and the United States Trustee (UST), objected to confirmation of debtor's proposed reorganization plan. The United States Bankruptcy Court for the Northern District of Texas, Stacey G. C. Jernigan, Chief Judge, overruled the objections and subsequently granted motion of co-founder and creditors to directly appeal confirmation order to Court of Appeals. Following consolidation of direct appeals, debtor moved to dismiss appeal as equitably moot.

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

equitable mootness did not bar review of creditors' claims, even though, because no stay of the plan pending appeal was granted, the plan had been substantially consummated;

the plan was properly classified as a reorganization plan, allowing for automatic discharge of its debts, notwithstanding debtor's “wind down” of its portfolio management;

the plan satisfied the absolute-priority rule;

failure of “Independent Directors” to file periodic financial reports as required by bankruptcy rule did not bar the plan's confirmation;

the Bankruptcy Court did not clearly err in finding that, despite their purported independence, debtor's publicly traded investment funds were entities "owned and/or controlled by" debtor's co-founder;

the plan's non-debtor exculpation provision violated the Bankruptcy Code to the extent it extended beyond debtor, unsecured creditors committee, and "Independent Directors" selected by committee to act as "quasitrustee" for debtor; and

the plan's injunction provision was not unlawfully overbroad or vague.

Motion to dismiss appeal denied; judgment affirmed in part, reversed in part, and remanded.

Previous opinion, 2022 WL 3571094, withdrawn.

Procedural Posture(s): On Appeal; Objection to Confirmation of Plan; Motion to Dismiss.

***424** Appeal from the United States Bankruptcy Court for the Northern District of Texas, USDC No. 19-34054, USDC No. 3:21-CV-538, Stacey G. C. Jernigan, Chief Judge

Attorneys and Law Firms

Davor Rukavina, Esq., Julian Preston Vasek, Munsch Hardt Kopf & Harr, P.C., Dallas, TX, for Appellants NexPoint Advisors, L.P., Highland Capital Management Fund Advisors, L.P.

David R. Fine, Esq., K & L Gates, L.L.P., Harrisburg, PA, A. Lee Hogewood, Emily K. Mather, K & L Gates, L.L.P., Raleigh, NC, for Appellants Highland Income Fund, NexPoint Strategic Opportunities Fund, Highland Global Allocation Fund, NexPoint Capital, Incorporated,

Davor Rukavina, Esq., Munsch Hardt Kopf & Harr, P.C., Dallas, TX, for Appellant James Dondero.

Douglas Scott Draper, Esq., Heller, Draper & Horn, L.L.C., New Orleans, LA, for Appellants The Dugaboy Investment Trust, Get Good Trust.

Melissa Sue Hayward, Esq., Zachery Z. Annable, Esq., Hayward, P.L.L.C., Dallas, TX, Jeffrey N. Pomerantz, Pachulski Stang Ziehl & Jones, L.L.P., Los Angeles, CA, Roy Theodore Englert, Jr., Kramer Levin Naftalis & Frankel, L.L.P., Washington, DC, for Appellee.

George W. Hicks, Jr., Kirkland & Ellis, L.L.P., Washington, DC, for Amicus Curiae.

Before Wiener, Graves, and Duncan, Circuit Judges.

ON PETITION FOR REHEARING

Stuart Kyle Duncan, Circuit Judge:

The petition for panel rehearing is GRANTED. We withdraw our previous opinion, reported at 2022 WL 3571094, and substitute the following:

Highland Capital Management, L.P., a Dallas-based investment firm, managed billion-dollar, publicly traded investment portfolios for nearly three decades. By 2019, however, myriad unpaid judgments and liabilities forced Highland Capital to file for Chapter 11 bankruptcy. This provoked a nasty breakup between Highland Capital and its co-founder James Dondero. Under those trying circumstances, the bankruptcy court successfully mediated with the largest creditors and ultimately confirmed a reorganization plan amenable to most of the remaining creditors.

Dondero and other creditors unsuccessfully objected to the confirmation order and then sought review in this court. In turn, Highland Capital moved to dismiss their appeal as equitably moot. First, we hold that equitable mootness does not bar our review of any claim. Second, we affirm the confirmation order in large part. We reverse only insofar as the plan exculpates certain non-debtors in violation of 11 U.S.C. § 524(e), strike those few parties from the plan's exculpation, and affirm on all remaining grounds.

I. BACKGROUND

A. Parties

In 1993, Mark Okada and appellant James Dondero co-founded Highland Capital Management, L.P. ("Highland Capital") in Dallas. Highland Capital managed portfolios and assets for other investment advisers and funds through a complex of entities under the Highland umbrella. Highland Capital's ownership-interest holders included Hunter Mountain Investment ***425** Trust (99.5%); appellant The Dugaboy Investment Trust, Dondero's family trust (0.1866%);[1] Okada, personally and through trusts (0.0627%); and Strand Advisors, Inc. (0.25%), the only general partner, which Dondero wholly owned.

[1] The Dugaboy Investment Trust appeals alongside Dondero's other family trust Get Good Trust (collectively, the "Trusts").

Dondero also manages two of Highland Capital's clients—appellants Highland Capital Management Fund Advisors, L.P. and NexPoint Advisors, L.P. (the "Advisors"). Both the Advisors and Highland Capital serviced and advised billion-dollar, publicly traded investment funds for appellants Highland Income Fund, NexPoint Strategic Opportunities Fund, Highland Global Allocation Fund, and NexPoint Capital, Inc. (collectively, the "Funds"), among others. For example, on behalf of the Funds, Highland Capital managed certain investment vehicles known as collateral loan obligations ("CLOs") under individualized servicing agreements.

B. Bankruptcy Proceedings

Strapped with a series of unpaid judgments, Highland Capital filed for Chapter 11 bankruptcy in the District of Delaware in October 2019. The creditors included Highland Capital's interest holders, business affiliates, contractors, former partners, employees, defrauded investors, and unpaid law firms. Among those creditors, the Office of the United States Trustee appointed a four-member Unsecured Creditors' Committee (the "Committee").[2] *See* 11 U.S.C. § 1102(a)(1), (b)(1). Throughout the bankruptcy proceedings, the Committee investigated Highland Capital's past and current operations, oversaw its continuing operations, and negotiated the reorganization plan. *See id.* § 1103(c). Upon the Committee's request, the court transferred the case to the Northern District of Texas in December 2019.

2 First, Redeemer Committee of the Highland Crusader Fund had obtained a $191 million arbitration award after a decade of litigation against Highland Capital. Second, Acis Capital Management, L.P. and Acis Capital Management GP, LLC had sued Highland Capital after facing an adverse $8 million arbitration award, arising in part from its now-extinguished affiliation. Third, UBS Securities LLC and UBS AG London Branch had received a $1 billion judgment against Highland Capital following a 2019 bench trial in New York. Fourth, discovery vendor Meta-E Discovery had $779,000 in unpaid invoices. The Committee members are not parties on appeal.

Highland Capital's reorganization did not proceed under the governance of a traditional Chapter 11 trustee. Instead, the Committee reached a corporate governance settlement agreement to displace Dondero, which the bankruptcy court approved in January 2020. Under the agreed order, Dondero stepped down as director and officer of Highland Capital and Strand to be an unpaid portfolio manager and "agreed not to cause any Related Entity ... to terminate any agreements" with Highland Capital. The Committee selected a board of three independent directors to act as a quasitrustee and to govern Strand and Highland Capital: James Seery Jr., John Dubel, and retired Bankruptcy Judge Russell Nelms (collectively, the "Independent Directors"). The order also barred any claim against the Independent Directors in their official roles without the bankruptcy court's authorizing the claim as a "colorable claim[ ] of willful misconduct or gross negligence." Six

months later, at the behest of the creditors, the bankruptcy court appointed Seery as Highland Capital's Chief Executive Officer, Chief Restructuring Officer, and Foreign Representative. The order contained an identical bar on claims against Seery ***426** acting in these roles. Neither order was appealed.

Throughout summer 2020, Dondero proposed several reorganization plans, each opposed by the Committee and the Independent Directors. Unpersuaded by Dondero, the Committee and Independent Directors negotiated their own plan. When Dondero's plans failed, he and other creditors began to frustrate the proceedings by objecting to settlements, appealing orders, seeking writs of mandamus, interfering with Highland Capital's management, threatening employees, and canceling trades between Highland Capital and its clients. *See Highland Cap. Mgmt., L.P. v. Dondero (In re Highland Cap. Mgmt., L.P.)*, Ch. 11 Case No. 19-34054-SGJ11, Adv. No. 20-03190-SGJ11, 2021 WL 2326350, at *1, *26 (Bankr. N.D. Tex. June 7, 2021) (holding Dondero in civil contempt, sanctioning him $100,000, and comparing this case to a "nasty divorce"). In Seery's words, Dondero wanted to "burn the place down" because he did not get his way. The Independent Directors insisted Dondero resign from Highland Capital, which he did in October 2020.

Highland Capital, meanwhile, proceeded toward confirmation of its reorganization plan—the Fifth Amended Plan of Reorganization of Highland Capital Management, L.P. (the "Plan"). In August 2020, the Independent Directors filed the Plan and an accompanying disclosure statement with the support of the Committee. *See* 11 U.S.C. §§ 1121, 1125. The bankruptcy court approved the statement as well as proposed notice and voting procedures for creditors, teeing up confirmation. Leading up to the confirmation hearing, the Advisors and the Funds asked the court to bar Highland Capital from trading or disposing of CLO assets pending confirmation. The bankruptcy court denied the request, and Highland Capital declined to voluntarily abstain and continued to manage the CLO assets.

Before confirmation, Dondero and other creditors (including several non-appellants) filed over a dozen objections to the Plan. Like Dondero, the United States Trustee primarily objected to the Plan's exculpation of certain non-debtors as unlawful. Highland Capital voluntarily modified the Plan to resolve six such objections. The Plan proposed to create eleven classes of creditors and equity holders and three classes of administrative claimants. *See* 11 U.S.C. § 1122. Of the voting-eligible classes, classes 2, 7, and 9 voted to accept the Plan while classes 8, 10, and 11 voted to reject it.

C. Reorganization Plan

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

The Plan works like this: It dissolves the Committee, and creates four entities—the Claimant Trust, the Reorganized Debtor, HCMLP GP LLC, [3] and the Litigation Sub-Trust. Administered by its trustee Seery, the Claimant Trust "wind[s]-down" Highland Capital's estate over approximately three years by liquidating its assets and issuing distributions to class-8 and -9 claimants as trust beneficiaries. Highland Capital vests its ongoing servicing agreements with the Reorganized Debtor, which "among other things" continues to manage the CLOs and other investment portfolios. The Reorganized Debtor's only general partner is HCMLP GP LLC. And the Litigation Sub-Trust resolves pending claims against Highland Capital under the direction of its trustee Marc Kirschner.

3 The Plan calls this entity "New GP LLC," but according to the motion to dismiss as equitably moot, the new general partner was later named HCMLP GP LLC. For the sake of clarity, we use HCMLP GP LLC.

***427** The whole operation is overseen by a Claimant Trust Oversight Board (the "Oversight Board") comprised of four creditor representatives and one restructuring advisor. The Claimant Trust wholly owns the limited partnership interests in the Reorganized Debtor, HCMLP GP LLC, and the Litigation Sub-Trust. The Claimant Trust (and its interests) will dissolve either at the soonest of three years after the effective date (August 2024) or (1) when it is unlikely to obtain additional proceeds to justify further action, (2) all claims and objections are resolved, (3) all distributions are made, and (4) the Reorganized Debtor is dissolved.

Anticipating Dondero's continued litigiousness, the Plan shields Highland Capital and bankruptcy participants from lawsuits through an exculpation provision, which is enforced by an injunction and a gatekeeper provision (collectively, "protection provisions"). The protection provisions extend to nearly all bankruptcy participants: Highland Capital and its employees and CEO; Strand; the Independent Directors; the Committee; the successor entities and Oversight Board; professionals retained in this case; and all "Related Persons" [4] (collectively, "protected parties"). [5]

4 The Plan generously defines "Related Persons" to include all former, present, and future officers, directors, employees, managers, members, financial advisors, attorneys, accountants, investment bankers, consultants, professionals, advisors, shareholders, principals, partners, heirs, agents, other representatives, subsidiaries, divisions, and managing companies.

5 The Plan expressly excludes from the protections Dondero and Okada; NexPoint Advisors, L.P.; Highland Capital Management Fund Advisors, L.P.; their subsidiaries, managed entities, managed entities, and members; and the Dugaboy Investment Trust and its trustees, among others.

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

The Plan exculpates the protected parties from claims based on any conduct "in connection with or arising out of" (1) the filing and administration of the case, (2) the negotiation and solicitation of votes preceding the Plan, (3) the consummation, implementation, and funding of the Plan, (4) the offer, issuance, and distribution of securities under the Plan before or after the filing of the bankruptcy, and (5) any related negotiations, transactions, and documentation. But it excludes "acts or omissions that constitute bad faith, fraud, gross negligence, criminal misconduct, or willful misconduct" *and* actions by Strand and its employees predating the appointment of the Independent Directors.

Under the Plan, bankruptcy participants are enjoined "from taking any actions to interfere with the implementation or consummation of the Plan" or filing any claim related to the Plan or proceeding. Should a party seek to bring a claim against any of the protected parties, it must go to the bankruptcy court to "first determin[e], after notice and a hearing, that such claim or cause of action represents a colorable claim of any kind." Only then may the bankruptcy court "specifically authoriz[e]" the party to bring the claim. The Plan reserves for the bankruptcy court the "sole and exclusive jurisdiction to determine whether a claim or cause of action is colorable" and then to adjudicate the claim if the court has jurisdiction over the merits.

D. Confirmation Order

At a February 2021 hearing, the bankruptcy court confirmed the Plan from the bench over several remaining objections. *See* FED R. BANKR. P. 3017–18; 11 U.S.C. §§ 1126, 1128, 1129. In its later-written decision, the bankruptcy court observed that Highland Capital's bankruptcy was "not a garden variety chapter 11 case." The type of debtor, the reason for the ***428** bankruptcy filing, the kinds of creditor claims, the corporate governance structure, the unusual success of the mediation efforts, and the small economic interests of the current objectors all make this case unique.

The confirmation order criticized Dondero's behavior before and during the bankruptcy proceedings. The court could not "help but wonder" if Highland Capital's deficit "was necessitated because of enormous litigation fees and expenses incurred" due to Highland Capital's "culture of litigation." Recounting Highland Capital's litigation history, it deduced that Dondero is a "serial litigator." It reasoned that, while "Dondero wants his company back," this "is not a good faith basis to lob objections to the Plan." It attributed Dondero's bad faith to the Advisors, the Trusts, and the Funds, given the "remoteness of their economic interests." For example, the bankruptcy court "was not convinced of the[ ] [Funds'] independence" from Dondero because the Funds' board members did not testify and had "engaged with the Highland complex for many years." And so the bankruptcy court "consider[ed] them all to be marching pursuant to the orders of Mr. Dondero." The court, meanwhile, applauded the members of the Committee for their "wills of steel" for

fighting "hard before and during this Chapter 11 Case" and "represent[ing] their constituency ... extremely well."

On the merits of the Plan, the bankruptcy court again approved the Plan's voting and confirmation procedures as well as the fairness of the Plan's classes. *See* 11 U.S.C. §§ 1122, 1125(a)–(c). The court held the Plan complied with the statutory requirements for confirmation. *See id.* §§ 1123(a)(1)–(7), 1129(a)(1)–(7), (9)–(13). Because classes 8, 10, and 11 had voted to reject the Plan, it was confirmable only by cramdown.[6] *See id.* § 1129(b). The bankruptcy court found that the Plan treated the dissenting classes fairly and equitably and satisfied the absolute-priority rule, so the Plan was confirmable. *See id.* § 1129(b)(2)(B)–(C). The court also concluded that the protection provisions were fair, equitable, and reasonable, as well as "integral elements" of the Plan under the circumstances, and were within both the court's jurisdiction and authority. The court confirmed the Plan as proposed and discharged Highland Capital's debts. *Id.* § 1141(d)(1). After confirmation and satisfaction of several conditions precedent, the Plan took effect August 11, 2021.

6 The bankruptcy court must proceed by nonconsensual confirmation, or "cramdown," 11 U.S.C. § 1129(b), when a class of unsecured creditors rejects a Chapter 11 reorganization plan, *id.* § 1129(a)(8), but at least one impaired class accepts it, *id.* § 1129(a)(10). A cramdown requires that the plan be "fair and equitable" to dissenting classes and satisfy the absolute priority rule—that is, dissenting classes are paid in full before any junior class can retain any property. *Id.* § 1129(b)(2)(B); *see Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 441–42, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999).

E. The Appeal

Dondero, the Advisors, the Funds, and the Trusts (collectively, "Appellants") timely appealed, objecting to the Plan's legality and some of the bankruptcy court's factual findings.[7] Together with Highland Capital, Appellants moved to directly appeal the confirmation order to this court, which the bankruptcy court granted. *See* 28 U.S.C. § 158(d). A motions panel certified and consolidated the direct appeals. *See ibid.* Both the bankruptcy court ***429** and the motions panel declined to stay the Plan's confirmation pending appeal. Given the Plan's substantial consummation since its confirmation, Highland Capital moved to dismiss the appeal as equitably moot, a motion the panel ordered carried with the case.

7 The Trusts adopt the Funds' and the Advisors' briefs in full, and Dondero adopts the Funds' brief in full and the Advisors' brief in part. FED. R. APP. P. 28(i).

* * *

We first consider equitable mootness and decline to invoke it here. We then turn to the merits, conclude the Plan exculpates certain non-debtors beyond the bankruptcy court's authority, and affirm in all other respects.

II. STANDARD OF REVIEW

A confirmation order is an appealable final order, over which we have jurisdiction. *Bullard v. Blue Hills Bank*, 575 U.S. 496, 502, 135 S.Ct. 1686, 191 L.Ed.2d 621 (2015); *see* 28 U.S.C. §§ 158(d), 1291. This court reviews a bankruptcy court's factual findings for clear error and legal conclusions *de novo*. *Evolve Fed. Credit Union v. Barragan-Flores (In re Barragan-Flores)*, 984 F.3d 471, 473 (5th Cir. 2021) (citation omitted).

III. EQUITABLE MOOTNESS

Highland Capital moved to dismiss this appeal as equitably moot. It argues we should abstain from appellate review because clawing back the implemented Plan "would generate untold chaos." We disagree and deny the motion.

The judge-made doctrine of equitable mootness allows appellate courts to abstain from reviewing bankruptcy orders confirming "complex plans whose implementation has substantial secondary effects." *New Indus., Inc. v. Byman (In re Sneed Shipbuilding, Inc.)*, 916 F.3d 405, 409 (5th Cir. 2019) (citing *In re Trib. Media Co.*, 799 F.3d 272, 274, 281 (3d Cir. 2015)). It seeks to balance "the equitable considerations of finality and good faith reliance on a judgment" and "the right of a party to seek review of a bankruptcy order adversely affecting him." *In re Manges*, 29 F.3d 1034, 1039 (5th Cir. 1994) (quoting *First Union Real Estate Equity & Mortg. Inv. v. Club Assocs. (In re Club Assocs.)*, 956 F.2d 1065, 1069 (11th Cir. 1992)); *see In re Hilal*, 534 F.3d 498, 500 (5th Cir. 2008); *see also* 7 Collier on Bankruptcy ¶ 1129.09 (16th ed.), LexisNexis (database updated June 2022) (observing "the equitable mootness doctrine is embraced in every circuit").[8]

8 The doctrine's atextual balancing act has been criticized. *See In re Pac. Lumber Co.*, 584 F.3d 229, 240 (5th Cir. 2009) ("Despite its apparent virtues, equitable mootness is a judicial anomaly."); *In re One2One Commc'ns, LLC*, 805 F.3d 428, 438–54 (3rd Cir. 2015) (Krause, J., concurring); *In re UNR Indus., Inc.*, 20 F.3d 766, 769 (7th Cir. 1994) (banishing the term "equitable mootness" as a misnomer); *In re Cont'l Airlines*, 91 F.3d 553, 569 (3d Cir. 1996) (en banc) (Alito, J., dissenting); *see also* Bruce A. Markell, *The Needs of the Many: Equitable Mootness' Pernicious Effects*, 93 Am. Bankr. L.J. 377, 393–96 (2019) (addressing

the varying applications between circuits). *But see In re Trib. Media*, 799 F.3d at 287–88 (Ambro, J., concurring) (highlighting some benefits of the equitable mootness doctrine).

This court uses equitable mootness as a “scalpel rather than an axe,” applying it claim-by-claim, instead of appeal-by-appeal. *In re Pac. Lumber Co. (Pacific Lumber)*, 584 F.3d 229, 240–41 (5th Cir. 2009). For each claim, we analyze three factors: “(i) whether a stay has been obtained, (ii) whether the plan has been ‘substantially consummated,’ and (iii) whether the relief requested would affect either the rights of parties not before the court or the success of the plan.” *In re Manges*, 29 F.3d at 1039 (citing ***430** *In re Block Shim Dev. Co.*, 939 F.2d 289, 291 (5th Cir. 1991); and *Cleveland, Barrios, Kingsdorf & Casteix v. Thibaut*, 166 B.R. 281, 286 (E.D. La. 1994)); *see also, e.g., In re Blast Energy Servs.*, 593 F.3d 418, 424–25 (5th Cir. 2010); *In re Ultra Petroleum Corp.*, No. 21-20049, 2022 WL 989389, at *5 (5th Cir. Apr. 1, 2022). No one factor is dispositive. *See In re Manges*, 29 F.3d at 1039.

Here, the bankruptcy court and this court declined to stay the Plan pending appeal, and it took effect August 11, 2021. Given the months of progress, no party meaningfully argues the Plan has not been substantially consummated.[9] *See Pacific Lumber*, 584 F.3d at 242 (observing “consummation includes transferring all or substantially all of the property covered by the plan, the assumption of business by the debtors' successors, and the commencement of plan distributions” (citing 11 U.S.C. § 1141; and *In re Manges*, 29 F.3d at 1041 n.10)). But that alone does not trigger equitable mootness. *See In re SCOPAC*, 624 F.3d 274, 281–82 (5th Cir. 2010). Instead, for each claim, the inquiry turns on whether the court can craft relief for that claim that would not have significant adverse consequences to the reorganization. Highland Capital highlights four possible disruptions: (1) the unraveling of the Claimant Trust and its entities, (2) the expense of disgorging disbursements, (3) the threat of defaulting on exit-financing loans, and (4) the exposure to vexatious litigation.

9 Since the Plan's effectuation, Highland Capital paid $2.2 million in claims to a committee member and $525,000 in “cure payments” to other counterparties. The independent directors resigned. The Reorganized Debtor, the Claimant Trust, HCMLP GP LLC, and the Litigation Sub-Trust were created and organized in accordance with the Plan. The bankruptcy court appointed the Oversight Board members, the Litigation Sub-Trust trustee, and the Claimant Trust trustee. Highland Capital assumed certain service contracts, including management of twenty CLOs with approximately $700 million in assets, and transferred its assets and estate claims to the successor entities. Highland Capital's pre-petition partnership interests were cancelled and cease to exist. A third party, Blue Torch Capital, infused $45 million in exit financing, fully guaranteed by the Reorganized Debtor, its operating subsidiaries, the Claimant Trust, and most of their assets. From the exit financing, an Indemnity Trust was created to indemnify claims that arise against the Reorganized Debtor, Claimant Trust, Ligation Sub-Trust, Claimant Trustee, Litigation Trustee, or Oversight Board members. The

> lone class-1 creditor withdrew its claim against Highland Capital. The lone class-2 creditor has been fully paid approximately $500,000 and issued a note of $5.2 million secured by $23 million of the Reorganized Debtor's assets. Classes 3 and 4 have been paid $165,412. Class 7 has received $5.1 million in distributions from the Claimant Trust, totaling 77% of class-7 claims filed.

Each party first suggests its own all-or-nothing equitable mootness applications. To Highland Capital, Appellants' broad requested remedy with only a minor economic stake demands mooting the entire appeal. To Appellants, the type of reorganization plan categorially bars equitable mootness, or, alternatively, Highland Capital's joining the motion to certify the appeal estops it from asserting equitable mootness. These arguments are unpersuasive and foreclosed by *Pacific Lumber.*

First, Highland Capital contends the entire appeal is equitably moot because Appellants, with only a minor economic stake and questionable good faith, “seek[ ] nothing less than a complete unravelling of the confirmed Plan.” It claims the court cannot “surgically excise[ ]” certain provisions, as the Funds request, because the Bankruptcy Code prohibits “modifications to confirmed plans after substantial consummation.” *See* 11 U.S.C. § 1127(b). Not so.

***431** “Although the Bankruptcy Code ... restricts post-confirmation plan modifications, it does not expressly limit appellate review of plan confirmation orders.” *Pacific Lumber*, 584 F.3d at 240 (footnote omitted) (citing 11 U.S.C. § 1127). This court may fashion “fractional relief” to minimize an appellate disturbance's effect on the rights of third parties. *In re Tex. Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d 324, 328 (5th Cir. 2013) (denying dismissal on equitable mootness grounds because the court “could grant partial relief ... without disturbing the reorganization”); *cf. In re Cont'l Airlines*, 91 F.3d 553, 571–72 (3d Cir. 1996) (en banc) (Alito, J., dissenting) (observing “a remedy could be fashioned in the present case to ensure that the [debtor's] reorganization is not undermined”). In short, Highland Capital's speculations are farfetched, as the court may fashion the remedy it sees fit without upsetting the reorganization.

Second, Appellants contend that equitable mootness cannot apply—full-stop—because this appeal concerns a liquidation plan, not a reorganization plan. We reject that premise. *See infra* Part IV.A. Even if it were correct, however, this court has conducted the equitable-mootness inquiry for a Chapter 11 liquidation plan in the past. *See In re Superior Offshore Int'l, Inc.*, 591 F.3d 350, 353–54 (5th Cir. 2009). And other circuits have squarely rejected the categorical bar proposed by Appellants. *See In re Abengoa Bioenergy Biomass of Kan., LLC*, 958 F.3d 949, 956–57 (10th Cir. 2020); *In re BGI, Inc.*, 772 F.3d 102, 107–09 (2d Cir. 2014). We do the same.

Finally, Appellants assert that because Highland Capital and NexPoint Advisors, L.P. jointly moved to certify the appeal, it should be estopped from arguing the appeal is equitably moot. They cite no legal support for that approach. We decline to adopt it.

Instead, we proceed with a claim-by-claim analysis, as our precedent requires. Highland Capital suggests only two claims are equitably moot: (1) the protection-provisions challenge and (2) the absolute-priority-rule challenge. Neither provides a basis for equitable mootness.

For the protection provisions, Highland Capital anticipates that, without the provisions, its officers, employees, trustees, and Oversight Board members would all resign rather than be exposed to Dondero-initiated litigation. Those resignations would disrupt the Reorganized Debtor's operation, "significant[ly] deteriorat[ing] asset values due to uncertainty." Appellants disagree, offering several instances when this court has reviewed release, exculpation, and injunction provisions over calls for equitable mootness. *See, e.g., In re Hilal*, 534 F.3d at 501; *Pacific Lumber*, 584 F.3d at 252; *In re Thru Inc.*, 782 F. App'x 339, 341 (5th Cir. 2019) (per curiam). In response, Highland Capital distinguishes this case because the provisions are "integral to the consummated plans." *See In re Charter Commc'ns, Inc.*, 691 F.3d 476, 486 (2d Cir. 2012). We again reject that premise. *See infra* Part IV.E.1. In any event, Appellants have the better argument.

We have before explained that "equity strongly supports appellate review of issues consequential to the integrity and transparency of the Chapter 11 process." *In re Hilal*, 534 F.3d 498, 500 (5th Cir. 2008). That is so because "the goal of finality sought in equitable mootness analysis does not outweigh a court's duty to protect the integrity of the process." *Pacific Lumber*, 584 F.3d at 252. As in *Pacific Lumber*, the legality of a reorganization plan's non-consensual non-debtor release is consequential to the Chapter 11 process and so should not escape appellate review ***432** in the name of equity. *Ibid.* The same is true here. Equitable mootness does not bar our review of the protection provisions.

For the absolute-priority-rule challenge, [10] Highland Capital contends our review requires us to "rejigger class recoveries." *Pacific Lumber* is again instructive. There, the court declined to apply equitable mootness to a secured creditor's absolute-priority-rule challenge, as no other panel had extended the doctrine so far. *Id.* at 243. Similarly, Highland Capital fails to identify a single case in which this court has declined review of the treatment of a class of creditor's claims resulting from a cramdown. *See id.* at 252. Regardless, Appellants challenge the distributions to classes 8, 10, and 11. According to Highland Capital's own declaration, "Class 8 General Unsecured Claims have received their Claimant Trust Interests." But there is no evidence that classes 10 or 11 have received any distributions. *Contra Pacific Lumber*, 584 F.3d at 251 (holding certain claims equitably moot where "the smaller unsecured creditors" had already "received payment for their claims"). As a result, the relief requested would not affect third parties or the success of the Plan. *See In re Manges*, 29 F.3d at 1039. The doctrine of equitable mootness does not bar our review of the cramdown and treatment of class-8 creditors.

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

10 While the issue is nearly forfeited for inadequate briefing, it fails on the merits regardless. *See Roy v. City of Monroe*, 950 F.3d 245, 251 (5th Cir. 2020).

We DENY Highland Capital's motion to dismiss the appeal as equitably moot.

IV. DISCUSSION

As to the merits, Appellants fire a bankruptcy-law blunderbuss. They contest the Plan's classification as a reorganization plan, the Plan's satisfaction of the absolute priority rule, the Plan's confirmation despite Highland Capital's noncompliance with Bankruptcy Rule 2015.3, and the sufficiency of the evidence supporting the court's factual finding that the Funds are "owned/controlled" by Dondero. For each, we disagree and affirm. We do, however, agree with Appellants that the bankruptcy court exceeded its statutory authority under § 524(e) by exculpating certain non-debtors, and so we reverse and vacate the Plan only to that extent.

A. Discharge of Debt

We begin with the Plan's classification as a reorganization plan, allowing for automatic discharge of the debts. The confirmation of a Chapter 11 restructuring plan "discharges the debtor from any [pre-confirmation] debt" unless, under the plan, the debtor liquidates its assets, stops "engag[ing] in [its] business after consummation of the plan," and would be denied discharge in a Chapter 7 case. 11 U.S.C. § 1141(d)(1), (3); *see In re Sullivan*, No. 99-11107, 234 F.3d 705, 2000 WL 1597984, at *2 (5th Cir. Sept. 26, 2000) (per curiam). The bankruptcy court concluded Highland Capital continued to engage in business after plan consummation, so its debts are automatically discharged. The Trusts call foul because, in their view, Highland Capital's "wind down" of its portfolio management is not a continuation of its business. We disagree.

Whether a corporate debtor "engages in business" is "relatively straightforward." *Um v. Spokane Rock I, LLC*, 904 F.3d 815, 819 (9th Cir. 2018) (contrasting the more complex question for individual debtors); *see Grausz v. Sampson (In re Grausz)*, 63 F. App'x 647, 650 (4th Cir. 2003) (per curiam) (same). That is, "a business entity will not engage in business post-bankruptcy when its assets are liquidated and the entity is dissolved." ***433** *Um*, 904 F.3d at 819 (collecting cases). [11] But even a temporary continuation of business after a plan's confirmation is sufficient to discharge a Chapter 11 debtor's debt. *See In re T-H New Orleans Ltd. P'ship*, 116 F.3d 790, 804 n.15 (5th Cir. 1997) (recognizing a debtor's "conducting business for two years following Plan confirmation satisfies § 1141(d)(3)(B)" (citation omitted)). That is the case here.

11 *See, e.g.*, *In re W. Asbestos Co.*, 313 B.R. 832, 853 (Bankr. N.D. Cal. 2003) (holding corporate debtor was not engaging in business by merely having directors and officers, rights under an insurance policy, and claims against it); *In re Wood Fam. Ints., Ltd.*, 135 B.R. 407, 410 (Bankr. D. Colo. 1989) (holding corporate debtor was not engaging in business when the plan called for liquidation and discontinuation of its business upon confirmation).

By the plain terms of the Plan, Highland Capital has and will continue its business as the Reorganized Debtor for several years. Indeed, much of this appeal concerns objections to Highland Capital's "continu[ing] to manage the assets of others." Because the Plan contemplates Highland Capital "engag[ing] in business after consummation," 11 U.S.C. § 1141(d)(1), the bankruptcy court correctly held Highland Capital was eligible for automatic discharge of its debts. [12]

12 For the same reasons, we reject the Trusts' follow-on argument extending the same logic to the protection provisions.

B. Absolute Priority Rule

Next, we consider the Plan's compliance with the absolute-priority rule. When assessing whether a plan is " 'fair and equitable" in a cramdown scenario, courts must invoke the absolute-priority rule. 11 U.S.C. § 1129(b)(1); *see* 7 COLLIER ON BANKRUPTCY ¶ 1129.04. Under that rule, if a class of unsecured claimants rejects a plan, the plan must provide that those claimants be paid in full on the effective date *or* any junior interest "will not receive or retain under the plan ... any property." 11 U.S.C. § 1129(b)(2)(B). [13]

13 *See Pacific Lumber*, 584 F.3d at 244 (noting the rule "enforces a strict hierarchy of [creditor classes'] rights defined by state and federal law" to protect dissenting creditor classes); *see also In re Geneva Steel Co.*, 281 F.3d 1173, 1180 n.4 (10th Cir. 2002) ("[U]nsecured creditors stand ahead of investors in the receiving line and their claims must be satisfied before any investment loss is compensated." (citations omitted)).

Because class-8 claimants voted against the Plan, the bankruptcy court proceeded by nonconsensual confirmation. The court concluded the Plan was fair and equitable to class 8 and its distributions were in line with the absolute-priority rule. 11 U.S.C. § 1129(b)(2)(B). The Advisors claim the Plan violates the absolute priority rule by giving class-10 and -11 claimants a "Contingent Claimant Trust Interest" without fully satisfying class-8 claimants. We agree the absolute-priority rule applies, and the Plan plainly satisfies it.

The Plan proposed to pay 71% of class-8 creditors' claims with *pro rata* distributions of interest generated by the Claimant Trust and then *pro rata* distributions from liquidated Claimant Trust

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

assets. Classes 10 and 11 received a *pro rata* share of “Contingent Claimant Trust Interests,” defined as a Claimant Trust Interest vesting only when the Claimant Trustee certifies that all class-8 claimants have been paid indefeasibly in full and all disputed claims in class 8 have been resolved. Voilà: no interest junior to class 8 will receive any property until class-8 claimants are paid.

But the Advisors point to Highland Capital's testimony and briefs to suggest the ***434** Contingent Claimant Trust Interests (received by classes 10 and 11) are property in some sense because they have value. That argument is specious. Of course, the Contingent Claimant Trust Interests have some small probability of vesting in the future and, thus, has some *de minimis* present value. *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207-08, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988) (holding a junior creditor's receipt of a presently valueless equity interest is receipt of property). But the absolute-priority rule has never required us to bar junior creditors from ever receiving property. By the Plan's terms, no trust property vests with class-10 or -11 claimants “unless and until” class-8 claims “have been paid indefeasibly in full.” *See* 11 U.S.C. § 1129(b)(2)(B)(ii). That plainly comports with the absolute-priority rule.

C. Bankruptcy Rule 2015.3

We turn to whether the failure to comply with Bankruptcy Rule of Procedure 2015.3 bars the Plan's confirmation. The Independent Directors failed to file periodic financial reports per Federal Rule of Bankruptcy Procedure 2015.3(a) about entities “in which the [Highland Capital] estate holds a substantial or controlling interest.” The Advisors claim the failure dooms the Plan's confirmation because the Plan proponent failed to comply “with the applicable provisions of this title.” 11 U.S.C. § 1129(a)(2). We disagree.

Rule 2015.3 cannot be an applicable provision of Title 11 because the Federal Rules of Bankruptcy Procedure are not provisions of the Bankruptcy Code. *See Bonner v. Adams (In re Adams)*, 734 F.2d 1094, 1101 (5th Cir. 1984) (“The Bankruptcy Rules Enabling Act, 28 U.S.C. § 2075, provides that the Supreme Court may prescribe ‘by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure’ in bankruptcy courts.”); *cf. In re Mandel*, No. 20-40026, 2021 WL 3642331, at *6 n.7 (5th Cir. Aug. 17, 2021) (per curiam) (noting “Rule 2015.3 implements section 419 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,” which amended 28 U.S.C. § 2073). The Advisors' attempt to tether the rule to the bankruptcy trustee's general duties lacks any legal basis. *See* 11 U.S.C. §§ 704(a)(8), 1106(a)(1), 1107(a). The bankruptcy court, therefore, correctly overruled the Advisors' objection.

D. Factual Findings

One factual finding is in dispute, but we see no clear error. The bankruptcy court found that, despite their purported independence, the Funds are entities "owned and/or controlled by [Dondero]." The Funds ask the court to vacate the factual finding because it threatens the Funds' compliance with federal law and damages their reputations and values. According to the Funds, the characterization is unfair, as *they* are not litigious like Dondero and are completely independent from him. Highland Capital maintains Dondero has sole discretion over the Funds as their portfolio manager and through his control of the Advisors, so the finding is supported by the record.

"Clear error is a formidable standard: this court disturbs factual findings only if left with a firm and definite conviction that the bankruptcy court made a mistake." *In re Krueger*, 812 F.3d 365, 374 (5th Cir. 2016) (cleaned up). We defer to the bankruptcy court's credibility determinations. *See Randall & Blake, Inc. v. Evans (In re Canion)*, 196 F.3d 579, 587–88 (5th Cir. 1999).

Here, the bankruptcy court drew its factual finding from the testimony of Jason Post, the Advisors' chief compliance officer, and Dustin Norris, an executive vice ***435** president for the Funds and the Advisors. Post testified that the Funds have independent board members that run them. But the bankruptcy court found Post not credible because "he abruptly resigned" from Highland Capital at the same time as Dondero and is currently employed by Dondero. Norris testified that Dondero "owned and/or controlled" the Funds and Advisors. The bankruptcy court found Norris credible and relied on his testimony. The bankruptcy court also observed that none of the Funds' board members testified in the bankruptcy case and all "engaged with the Highland complex for many years." Because nothing in this record leaves us with a firm and definite conviction that the bankruptcy court made a mistake in finding that the Funds are "owned and/or controlled by [Dondero]," we leave the bankruptcy court's factual finding undisturbed.

E. The Protection Provisions

Finally, we address the legality of the Plan's protection provisions. As discussed, the Plan exculpates certain non-debtor third parties supporting the Plan from post-petition lawsuits not arising from gross negligence, bad faith, or willful or criminal misconduct. It also enjoins certain parties "from taking any actions to interfere with the implementation or consummation of the Plan." The injunction requires that, before any lawsuit is filed, the plaintiff must seek the bankruptcy court's approval of the claim as "colorable"—*i.e.*, the bankruptcy court acts as a gatekeeper. Together, the provisions screen and prevent bad-faith litigation against Highland Capital, its successors, and other bankruptcy participants that could disrupt the Plan's effectiveness.

The bankruptcy court deemed the provisions legal, necessary under the circumstances, and in the best interest of all parties. We agree, but only in part. Though the injunction and gatekeeping

provisions are sound, the exculpation of certain non-debtors exceeds the bankruptcy court's authority. We reverse and vacate that limited portion of the Plan.

1. *Non-Debtor Exculpation*

We start with the scope of the non-debtor exculpation. In a Chapter 11 bankruptcy proceeding, "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e). Contrary to the bankruptcy court's holding, the exculpation here partly runs afoul of that statutory bar on non-debtor discharge by reaching beyond Highland Capital, the Committee, and the Independent Directors. *See Pacific Lumber*, 584 F.3d at 251–53. We must reverse and strike the few unlawful parts of the Plan's exculpation provision.

The parties agree that *Pacific Lumber* controls and also that the bankruptcy court had the power to exculpate both Highland Capital and the Committee members. Appellants, however, submit the bankruptcy court improperly stretched *Pacific Lumber* to shield other non-debtors from breach-of-contract and negligence claims, in violation of § 524(e). Highland Capital counters that the exculpation provision is a commonplace Chapter 11 term, is appropriate given Dondero's litigious nature, does not implicate § 524(e), and merely provides a heightened standard of care.

To support that argument, Highland Capital highlights the distinction between a concededly unlawful release of all non-debtor liability and the Plain's limited exculpation of non-debtor post-petition liability. *See, e.g., In re PWS Holding Corp.*, 228 F.3d 224, 246–47 (3d Cir. 2000) (describing releases as "eliminating" a covered ***436** party's liability "altogether" while exculpation provisions "set[ ] forth the applicable standard of liability" in future litigation). According to Highland Capital, the Third and Ninth Circuits have adopted that distinction when applying § 524(e). *See Blixseth v. Credit Suisse*, 961 F.3d 1074, 1084 (9th Cir. 2020), *cert. denied*, ––– U.S. ––––, 141 S. Ct. 1394, 209 L.Ed.2d 132 (2021); *In re PWS Holding*, 228 F.3d at 246–47. Under those cases, narrow exculpations of post-petition liability for certain critical third-party non-debtors are lawful "appropriate" or "necessary" actions for the bankruptcy court to carry out the proceeding through its statutory authority under § 1123(b)(6) and § 105(a). *See* 11 U.S.C. § 1123(b)(6) ("[A] plan may ... include any other appropriate provision not inconsistent with the applicable provisions of this title."); *id* § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.").

Highland Capital reads *Pacific Lumber* as "in step with the law in [those] other circuits" by allowing a limited exculpation of post-petition liability. *Cf. Blixseth*, 961 F.3d at 1084. We disagree. As the Ninth Circuit acknowledged, our court in *Pacific Lumber* arrived at "a conclusion opposite [the Ninth Circuit's]." 961 F.3d at 1085 n.7. Moreover, the Ninth Circuit expressly disavowed

Pacific Lumber's rationale—that an exculpation provision provides a "fresh start" to a non-debtor in violation of § 524(e)—because, in the Ninth Circuit's view, the post-petition exculpation "affects only claims arising from the bankruptcy proceedings themselves." *Ibid.* We are not persuaded, as Highland Capital contends, that the Ninth Circuit was "sloppy" and simply "misread *Pacific Lumber.*" *See* O.A. Rec. 19:45–21:38.

The simple fact of the matter is that there is a circuit split concerning the effect and reach of § 524(e).[14] Our court along with the Tenth Circuit hold § 524(e) categorically bars third-party exculpations absent express authority in another provision of the Bankruptcy Code. *Pacific Lumber*, 584 F.3d at 252–53; *Landsing Diversified Props. v. First Nat'l Bank & Tr. Co. of Tulsa (In re W. Real Estate Fund, Inc.)*, 922 F.2d 592, 600 (10th Cir. 1990) (per curiam). By contrast, the Ninth Circuit joins the Second, Third, Fourth, Sixth, Seventh, and Eleventh Circuits in reading § 524(e) to allow varying degrees of limited third-party exculpations. *Blixseth*, 961 F.3d at 1084; *accord In re PWS Holding*, 228 F.3d at 246–47 (allowing third-party releases for "fairness, necessity to the reorganization, and specific factual findings to support these conclusions"); *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 143 (2d Cir. 2005); *In re A.H. Robins Co.*, 880 F.2d 694, 702 (4th Cir. 1989); *In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002); *In re Airadigm Commc'ns., Inc.*, 519 F.3d 640, 657 (7th Cir. 2008); *In re Seaside Eng'g & Surveying, Inc.*, 780 F.3d 1070, 1078 (11th Cir. 2015).

14 Amicus's contention that failing to adopt the Ninth Circuit's holding "would generate a clear circuit split" is wrong. There already is one. *See* Petition for Writ of Certiorari, *Blixseth v. Credit Suisse*, 141 S. Ct. 1394 (highlighting the circuits' divergent approaches to the non-debtor discharge bar under § 524(e)).

Our *Pacific Lumber* decision was not blind to the countervailing view, as it twice cites the Third Circuit's contrary holding in other contexts. *See* 584 F.3d at 241, 253 (citing *In re PWS Holding*, 228 F.3d at 236–37, 246). But we rejected the parsing between limited exculpations and full releases that Highland Capital now requests. We are obviously bound to apply our own precedent. *See* ***437** *Hidalgo Cnty. Emergency Serv. Found. v. Carranza (In re Hidalgo Cnty. Emergency Serv. Found.)*, 962 F.3d 838, 841 (5th Cir. 2020) ("Under our well-recognized rule of orderliness, ... a panel of this court is bound by circuit precedent." (citation omitted)).

Under *Pacific Lumber*, § 524(e) does not permit "absolv[ing] the [non-debtor] from any negligent conduct that occurred during the course of the bankruptcy" absent another source of authority. 584 F.3d at 252–53; *see also In re Zale Corp.*, 62 F.3d 746, 760 (5th Cir. 1995). At oral argument, Highland Capital pointed only to § 1123(b)(6) and § 105(a) as footholds. *See* O.A. Rec. 16:45–17:28. But in this circuit, § 105(a) provides no statutory basis for a non-debtor exculpation. *In re Zale*, 62 F.3d at 760 (noting "[a] § 105 injunction cannot alter another provision of the code" (citing *In re Oxford Mgmt., Inc.*, 4 F.3d 1329, 1334 (5th Cir. 1993))). And the same logic extends to §

WESTLAW © 2023 Thomson Reuters. No claim to original U.S. Government Works.

1123(b)(6), which allows a plan to "include any other appropriate provision *not inconsistent with the applicable provisions of this title.*" 11 U.S.C. § 1123(b)(6) (emphasis added).

Pacific Lumber identified two sources of authority to exculpate non-debtors. *See* 584 F.3d at 252–53. The first is to channel asbestos claims (not present here). *Id.* at 252 (citing 11 U.S.C. § 524(g)). The second is to provide a limited qualified immunity to creditors' committee members for actions within the scope of their statutory duties. *Pacific Lumber*, 584 F.3d at 253 (citing 11 U.S.C. § 1103(c)); *see In re Vitro S.A.B. de CV*, 701 F.3d 1031, 1069 (5th Cir. 2012). And, though not before the court in *Pacific Lumber*, we have also recognized a limited qualified immunity to bankruptcy trustees unless they act with gross negligence. *In re Hilal*, 534 F.3d at 501 (citing *In re Smyth*, 207 F.3d 758, 762 (5th Cir. 2000)); *accord Baron v. Sherman (In re Ondova Ltd.)*, 914 F.3d 990, 993 (5th Cir. 2019) (per curiam). If other sources exist, Highland Capital failed to identify them. So we see no statutory authority for the full extent of the exculpation here.

The bankruptcy court read *Pacific Lumber* differently. In its view, *Pacific Lumber* created an additional ground to exculpate non-debtors: when the record demonstrates that "costs [a party] might incur defending against suits alleging such negligence are likely to swamp either [it] or the consummated reorganization." 584 F.3d at 252. We do not read the decision that way. The bankruptcy court's underlying factual findings do not alter whether it has statutory authority to exculpate a non-debtor. That is the holding of *Pacific Lumber.*

That leaves one remaining question: whether the bankruptcy court can exculpate the Independent Directors under *Pacific Lumber.* We answer in the affirmative. As the bankruptcy court's governance order clarified, nontraditional as it may be, the Independent Directors were appointed to act together as the bankruptcy trustee for Highland Capital. Like a debtor-in-possession, the Independent Directors are entitled to all the rights and powers of a trustee. *See* 11 U.S.C. § 1107(a); 7 COLLIER ON BANKRUPTCY ¶ 1101.01. It follows that the Independent Directors are entitled to the limited qualified immunity for any actions short of gross negligence. *See In re Hilal*, 534 F.3d at 501. Under this unique governance structure, the bankruptcy court legally exculpated the Independent Directors.

In sum, our precedent and § 524(e) require any exculpation in a Chapter 11 reorganization plan be limited to the debtor, the creditors' committee and its members for conduct within the scope of their duties, 11 U.S.C. § 1103(c), and the trustees within the scope of their duties, ***438** *see Baron*, 914 F.3d at 993. And so, excepting the Independent Directors and the Committee members, the exculpation of non-debtors here was unlawful. Accordingly, the other non-debtor exculpations must be struck from the Plan. *See Pacific Lumber*, 584 F.3d at 253. [15]

15 Highland Capital, like the bankruptcy court, claims the *res judicata* effect of the January and July 2020 orders appointing the independent directors and appointing Seery as CEO

> binds the court to include the protection provisions here. We lack jurisdiction to consider collateral attacks on final bankruptcy orders even when it concerns whether the court properly exercised jurisdiction or authority at the time. *See Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 129 S.Ct. 2195, 174 L.Ed.2d 99 (2009); *In re Linn Energy, L.L.C.*, 927 F.3d 862, 866–67 (5th Cir. 2019) (quoting *Bailey*, 557 U.S. at 152, 129 S.Ct. 2195). To the extent Appellants seek to roll back the protections in the bankruptcy court's January 2020 and July 2020 orders (which is not clear from their briefing), such a collateral attack is precluded.
> As a result, the bankruptcy court was correct insofar as *those* orders have the effect of exculpating the Independent Directors and Seery in his executive capacities, but it was incorrect that *res judicata* mandates their inclusion in the Plan's new exculpation provision. Despite removal from the exculpation provision in the confirmation order, the Independent Directors' agents, advisors, and employees, as well as Seery in his official capacities are all exculpated to the extent provided in the January and July 2020 orders, given the orders' ongoing *res judicata* effects and our lack of jurisdiction to review those orders. But that says nothing of the effect of the Plan's exculpation provision.

As it stands, the Plan's exculpation provision extends to Highland Capital and its employees and CEO; Strand; the Reorganized Debtor and HCMLP GP LLC; the Independent Directors; the Committee and its members; the Claimant Trust, its trustee, and the members of its Oversight Board; the Litigation Sub-Trust and its trustee; professionals retained by the Highland Capital and the Committee in this case; and all "Related Persons." Consistent with § 524(e), we strike all exculpated parties from the Plan except Highland Capital, the Committee and its members, and the Independent Directors.

2. *Injunction & Gatekeeper Provisions*

We now turn to the Plan's injunction and gatekeeper provisions. Appellants object to the bankruptcy court's injunction as vague and the gatekeeper provision as overbroad. We are unpersuaded.

First, Appellants' primary contention—that the Plan's injunction "is broad" by releasing non-debtors in violation of § 524(e)—is resolved by our striking the impermissibly exculpated parties. *See supra* Part IV.E.1.

Second, Appellants dispute the permanency of the injunction for the legally exculpated parties by enjoining conduct "on and after the Effective Date." Even assuming the issue was preserved, [16] permanency alone is no reason to alter a bankruptcy court's otherwise-lawful injunction on appeal. *See In re Zale*, 62 F.3d at 759–60 (recognizing the bankruptcy court's jurisdiction to issue an injunction in the first place allowed it to issue a permanent injunction).

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

16 *See Roy*, 950 F.3d at 251 ("Failure adequately to brief an issue on appeal constitutes waiver of that argument." (citation omitted)).

Third, the Advisors argue that the injunction is "overbroad and vague" because it does not define what it means to "interfere" with the "implementation or consummation of the Plan." That is unsupported by the record. As the bankruptcy court recognized, the Plan defined what constitutes interference: (i) filing a lawsuit, (ii) enforcing judgments, (iii) enforcing security ***439** interests, (iv) asserting setoff rights, or (v) acting "in any manner" not conforming with the Plan. The injunction is not unlawfully overbroad or vague.

Finally, Appellants maintain that the gatekeeper provision impermissibly extends to unrelated claims over which the bankruptcy court lacks subject-matter jurisdiction. *See In re Craig's Stores of Tex., Inc.*, 266 F.3d 388, 390 (5th Cir. 2001) (noting a bankruptcy court retains jurisdiction post-confirmation only over "matters pertaining to the implementation or execution of the plan" (citations omitted)). While that may be the case, our precedent requires we leave that determination to the bankruptcy court in the first instance.

Courts have long recognized bankruptcy courts can perform a gatekeeping function. Under the "*Barton* doctrine," the bankruptcy court may require a party to "obtain leave of the bankruptcy court before initiating an action in district court when the action is against the trustee or other bankruptcy-court-appointed officer, for acts done in the actor's official capacity." *Villegas v. Schmidt*, 788 F.3d 156, 159 (5th Cir. 2015) (emphasis added) (quoting *Carter v. Rodgers*, 220 F.3d 1249, 1252 (11th Cir. 2000)); *accord Barton v. Barbour*, 104 U.S. 126, 26 L.Ed. 672 (1881).[17] In *Villegas*, we held "that a party must continue to file with the relevant bankruptcy court for permission to proceed with a claim against the trustee." 788 F.3d at 158. Relevant here, we left to the bankruptcy court, faced with pre-approval of a claim, to determine whether it had subject matter jurisdiction over that claim in the first instance. *Id.* at 158–59; *see, e.g., Carroll v. Abide*, 788 F.3d 502, 506–07 (5th Cir. 2015) (noting *Villegas* "rejected an argument that the *Barton* doctrine does not apply when the bankruptcy court lacked jurisdiction"). In other words, we need not evaluate whether the bankruptcy court would have jurisdiction under every conceivable claim falling under the widest interpretation of the gatekeeper provision. We leave that to the bankruptcy court in the first instance.[18]

17 The Advisors also maintain that Highland Capital is neither a receiver nor a trustee, so *Barton* has no application here. We disagree. Highland Capital, for all practical purposes, was a debtor in possession entitled to the rights of a trustee. *See* 7 Collier on Bankruptcy ¶ 1101.01 ("The debtor in possession is generally vested with all of the rights and powers of a trustee as

set forth in section 1106 ....”); *see also Carter*, 220 F.3d at 1252 n.4. (finding no distinction between bankruptcy court “approved” and bankruptcy court “appointed” officers).

18 For the same reasons, we also leave the applicability of *Barton*'s limited statutory exception to the bankruptcy and district courts in the first instance. *See* 28 U.S.C. § 959(a) (allowing suit, without leave of the appointing court, if the challenged acts relate to the trustee or debtor in possession “carrying on business connected with [their] property”).

* * *

In sum, the Plan violates § 524(e) but only insofar as it exculpates and enjoins certain non-debtors. The exculpatory order is therefore vacated as to all parties *except* Highland Capital, the Committee and its members, and the Independent Directors for conduct within the scope of their duties. We otherwise affirm the inclusion of the injunction and the gatekeeper provisions in the Plan. [19]

19 Nothing in this opinion should be construed to hinder the bankruptcy court's power to enjoin and impose sanctions on Dondero and other entities by following the procedures to designate them vexatious litigants. *See In re Carroll*, 850 F.3d 811, 815 (5th Cir. 2017) (per curiam). But non-debtor exculpation within a reorganization plan is not a lawful means to impose vexatious litigant injunctions and sanctions.

***440** V. CONCLUSION

Highland Capital's motion to dismiss the appeal as equitably moot is DENIED. The bankruptcy court's judgment is AFFIRMED in part, REVERSED in part, and REMANDED for further proceedings consistent with this opinion.

All Citations

48 F.4th 419, Bankr. L. Rep. P 83,811

End of Document © 2023 Thomson Reuters. No claim to original U.S. Government Works.

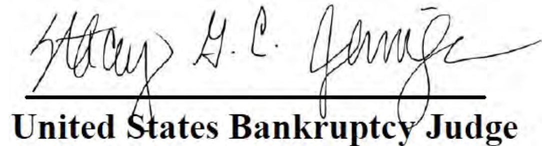
CLERK, U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS

ENTERED

THE DATE OF ENTRY IS ON THE COURT'S DOCKET

The following constitutes the ruling of the court and has the force and effect therein described.

Signed February 27, 2023



United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

In re:	§	
	§	Chapter 11
HIGHLAND CAPITAL MANAGEMENT, L.P.,	§	
	§	Case No. 19-34054-sgj11
Reorganized Debtor.	§	
	§	

MEMORANDUM OPINION AND ORDER ON REORGANIZED DEBTOR'S MOTION TO CONFORM PLAN [DE # 3503]

I. INTRODUCTION

This Memorandum Opinion and Order addresses a *Motion to Conform Plan* [DE # 3503] ("*Motion*") filed by Highland Capital Management, L.P. ("Highland" or the "Reorganized Debtor").[1] The *Motion* was filed in response to a ruling of the United States Court of Appeals for the Fifth Circuit ("Fifth Circuit") in connection with an appeal of the confirmation order on

[1] The court will sometimes use the term "Debtor" when referring to Highland during the post-petition/pre-confirmation time period.

Highland's Chapter 11 plan ("Plan"). As further explained herein, the Fifth Circuit affirmed the confirmation order in all respects except the following: it determined that certain ***exculpations*** in the Plan, as to certain parties, were impermissible pursuant to section 524(e) of the Bankruptcy Code and should be stricken as to those parties. More specifically, the Fifth Circuit held that the only parties properly entitled to Plan exculpations were: the Debtor, the Official Committee of Unsecured Creditors (the "UCC") and its members, and the "Independent Directors"[2] (collectively, the "Properly Exculpated Parties"). The Fifth Circuit then remanded "to the Bankruptcy Court for further proceedings in accordance with the opinion of this Court."[3]

Accordingly, the Reorganized Debtor filed the *Motion*, proposing that the bankruptcy court approve a scaled down defined term for "Exculpated Parties" in the Plan. This, says the Reorganized Debtor, is all that the Fifth Circuit's mandate required—i.e., a narrowing of the defined universe of persons who received exculpations under the Plan.

Three sets of parties objected to the *Motion*: (a) Highland Income Fund, NexPoint Strategic Opportunities Fund, Highland Global Allocation Fund, and NexPoint Capital, Inc. (the "Funds") [DE # 3539]; (b) the Dugaboy Investment Trust ("Dugaboy")[4] [DE # 3540]; and (c) NexPoint Advisors, L.P. and Highland Capital Management Fund Advisors, L.P. (the "Advisors") [DE # 3551].[5] These objectors argue that the Fifth Circuit's ruling requires more surgery on the Plan than simply narrowing the defined term for "Exculpated Parties." The Reorganized Debtor disagreed in a Reply [DE # 3566], and the court thereafter held a hearing to allow oral argument. The court gave an oral ruling from the bench at the hearing, stating that the Reorganized Debtor's

---

[2] The Independent Directors—consisting of James P. Seery, Jr., John Dubel, and Retired Bankruptcy Judge Russell Nelms—were appointed by the bankruptcy court and were comparable to "quasi-trustees."
[3] *NexPoint v. Highland Capital Management*, Case No. 21-10449 at DE # 213 (5th Cir. Sep. 12, 2022).
[4] Dugaboy is a family trust of James Dondero ("Mr. Dondero"), the co-founder and former CEO of the Debtor.
[5] It has been conceded at prior hearings that the Advisors are controlled by Mr. Dondero. The court assumes that is still the case.

proposal of simply changing the defined term in the Plan for "Exculpated Parties" would seem to properly address the Fifth Circuit's ruling and mandate, but the parties asked the court to draft a formal written Order providing its reasoning, for the parties' benefit and in case there were appeals of the court's ruling on the *Motion*. This constitutes the court's written ruling.

II. RELEVANT BACKGROUND

On October 16, 2019, Highland filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. On February 22, 2021, the bankruptcy court entered a Confirmation Order [DE # 1943] confirming the Fifth Amended Plan of Reorganization of Highland Capital Management, L.P. (as Modified) [Docket No. 1808] (as subsequently modified, the "Plan"). The Confirmation Order was appealed by the Funds, the Advisors, Dugaboy, the Get Good Trust (the latter of which is another family trust of Mr. Dondero), and Mr. Dondero in his individual capacity ("Appellants") [DE ## 1957, 1966, 1970, 1972]. Appellants' appeal was certified for direct appeal to the Fifth Circuit.

On August 19, 2022, the Fifth Circuit issued an opinion (the "Initial Fifth Circuit Opinion")[6] and a judgment ("Judgment") affirming in substantial part the Confirmation Order, stating that it reversed "only insofar as the plan exculpates certain non-debtors in violation of 11 U.S.C. § 524(e)," and would "strike those few parties from the plan's exculpation, and affirm on all remaining grounds."[7] The Fifth Circuit remanded to the bankruptcy court "for further proceedings in accordance with the opinion of this Court."[8]

---

[6] *NexPoint v. Highland Capital Management*, 2022 WL 3571094, Case No. 21-10449, slip opinion previously available at DE # 194 (5th Cir. Aug. 19, 2022). The Initial Fifth Circuit Opinion was attached to the Funds' objection to the *Motion* as an Exhibit A [DE # 3539].
[7] *Id.* at p. 2.
[8] *Id.*

On September 2, 2022, the Funds filed a short (four-and-one-half pages) motion for rehearing at the Fifth Circuit (the "Motion for Rehearing").[9] This was on the Friday before Labor Day. The Funds requested "that the Court narrowly amend the [Initial Fifth Circuit] Opinion in order to confirm the Court's holding that the impermissibly exculpated parties are similarly struck from the protections of the injunction and gatekeeper provisions of the plan (in other words, that such parties cannot constitute 'Protected Parties')." As later explained, the Plan contained distinct "Exculpation," "Injunctions," and "Gatekeeper" provisions. On September 7, 2022 (the Tuesday after Labor Day), the Fifth Circuit granted the Motion for Rehearing and, without entertaining responses or oral argument, withdrew the Initial Fifth Circuit Opinion and entered a substituted opinion (the "Final Fifth Circuit Opinion").[10] The Final Fifth Circuit Opinion ***replaced only one sentence*** that had been in the Initial Fifth Circuit Opinion:

> ***"The injunction and gatekeeper provisions are, on the other hand, perfectly lawful"*** [11]
>
> with the following sentence:
>
> ***"We now turn to the Plan's injunction and gatekeeper provisions."*** [12]

However, in the Final Fifth Circuit Opinion, same as the Initial Fifth Circuit Opinion, the Fifth Circuit stated that, with regard to the Confirmation Order, the panel would "reverse only insofar as the plan exculpates certain non-debtors in violation of 11 U.S.C. § 524(e), strike those few parties from the plan's exculpation, and affirm on all remaining grounds."[13] To be clear, no

---

[9] DE # 3539, Exhibit C thereto.
[10] *NexPoint v. Highland Capital Management*, 48 F.4th 419, Case No. 21-10449, slip opinion at DE # 210 (5th Cir. Sep. 7, 2022). The Final Fifth Circuit Opinion was attached to the Funds' objection to the *Motion* as an Exhibit C [DE # 3539]. Most subsequent references to the Final Fifth Circuit Opinion will cite to the published version of it in the West Reporter Service, appearing at 48 F.4th 419.
[11] *See* slip opinion, at p. 27 [DE # 3539, Exhibit A thereto].
[12] *See* Final Fifth Circuit Opinion, slip opinion at p. 28 [DE # 3539, Exhibit C thereto]. 48 F.4th at 438.
[13] 48 F.4th at 424.

findings, discussion, or rulings regarding the injunction and gatekeeper provisions that were in the Initial Fifth Circuit Opinion were disturbed.

The Fifth Circuit's docket reflects that it issued its Judgment and a mandate on September 12, 2022, remanding "to the Bankruptcy Court for further proceedings in accordance with the opinion of this Court."[14]

On October 7, 2022, the Fifth Circuit denied a motion by certain Appellants for a stay of the mandate.[15]

Thereafter, on January 10 and 23, 2023, petitions for *writ of certiorari* to the United States Supreme Court were filed by the Reorganized Debtor and certain Appellants.[16] There being no stay of the Final Fifth Circuit Opinion or the mandate, this court now issues this ruling on the *Motion*.

III. JURISDICTION

The bankruptcy court has jurisdiction to rule on the *Motion* pursuant to the mandate of the Fifth Circuit issued on September 12, 2022. Furthermore, the underlying statutory authority that is applicable is 11 U.S.C. §§ 105(a) and 1142.

IV. THE PLAN PROVISIONS THAT ARE CONCEIVABLY AT ISSUE

To put the relief sought in the *Motion* and the objections thereto into proper context, a review of three sets of Plan provisions is appropriate. First, the ***exculpation provisions***. Second, the ***injunction provisions***. Third, the ***gatekeeping provisions***. These all had distinct functions;

---

[14] *NexPoint v. Highland Capital Management*, Case No. 21-10449 at DE # 213 (5th Cir. Sep. 12, 2022).
[15] *Id.* at DE # 222 (5th Cir. Oct. 7, 2022).
[16] *Id.* at DE ## 227 & 228 (5th Cir. Jan. 10 & 23, 2023).

they were not in any way redundant. Sometimes they have been collectively referred to as the "***Protection Provisions***."

Exculpations. The Plan addressed Exculpation at Article IX.C thereof. The "Exculpation" provision, in pertinent part, stated as follows:

> Subject in all respects to ARTICLE XII.D of this Plan, to the maximum extent permitted by applicable law, ***no Exculpated Party will have or incur***, and each Exculpated Party is hereby exculpated from, any claim, obligation, suit, judgment, damage, demand, debt, right, Cause of Action, remedy, loss, and ***liability for conduct occurring on or after the Petition Date*** in connection with or arising out of (i) the filing and administration of the Chapter 11 Case; (ii) the negotiation and pursuit of the Disclosure Statement, the Plan, or the solicitation of votes for, or confirmation of, the Plan; (iii) the funding or consummation of the Plan (including the Plan Supplement) or any related agreements, instruments, or other documents, the solicitation of votes on the Plan, the offer, issuance, and Plan Distribution of any securities issued or to be issued pursuant to the Plan, including the Claimant Trust Interests, whether or not such Plan Distributions occur following the Effective Date; (iv) the implementation of the Plan; and (v) any negotiations, transactions, and documentation in connection with the foregoing clauses (i)-(iv); provided, however, ***the foregoing will not apply to (a) any acts or omissions of an Exculpated Party arising out of or related to acts or omissions that constitute bad faith, fraud, gross negligence, criminal misconduct, or willful misconduct*** or (b) Strand or any Employee other than with respect to actions taken by such Entities from the date of appointment of the Independent Directors through the Effective Date. This exculpation shall be in addition to, and not in limitation of, all other releases, indemnities, exculpations, any other applicable law or rules, or any other provisions of this Plan, including ARTICLE IV.C.2, protecting such Exculpated Parties from liability. (Emphasis added.)

The Plan had a defined term for "Exculpated Parties," at Article I.B.62 that read as follows:

> "**Exculpated Parties**" means, collectively, (i) the Debtor and its successors and assigns, direct and indirect majority-owned subsidiaries, and the Managed Funds, (ii) the Employees, (iii) Strand, (iv) the Independent Directors, (v) the Committee, (vi) the members of the Committee (in their official capacities), (vii) the Professionals retained by the Debtor and the Committee in the Chapter 11 Case, (viii) the CEO/CRO; and (ix) the Related Persons of each of the parties listed in (iv) through (viii); provided, however, that, for the avoidance of doubt, none of James Dondero, Mark Okada, NexPoint Advisors, L.P. (and any of its subsidiaries and managed entities), the Charitable Donor Advised Fund, L.P. (and any of its

> subsidiaries, including CLO Holdco, Ltd., and managed entities), Highland CLO Funding, Ltd. (and any of its subsidiaries, members, and managed entities), Highland Capital Management Fund Advisors, L.P. (and any of its subsidiaries and managed entities), NexBank, SSB (and any of its subsidiaries), the Hunter Mountain Investment Trust (or any trustee acting for the trust), the Dugaboy Investment Trust (or any trustee acting for the trust), or Grant Scott is included in the term "Exculpated Party."

Simply stated, the Exculpation Provisions shielded a specified list of parties from any ***negligence liability*** for ***post-petition conduct*** in connection with the Highland Chapter 11 cases. The provisions effectuated ***an absolution of liability*** for the Exculpated Parties—but, again, only for mere negligent conduct occurring on or after the Petition Date and in connection with the case. It is also notable that the Exculpation Provisions deal only with pre-Effective Date Parties (i.e., not any parties created by the terms of the Plan, such as the Litigation Trustee or Claimant Trustee).

Injunctions. The Plan addresses Injunctions at Article IX.F, in the first three paragraphs thereof. The "Injunctions" provision, in pertinent part, stated as follows:

> Upon entry of the Confirmation Order, all Enjoined Parties are and shall be permanently enjoined, on and after the Effective Date, ***from taking any actions to interfere with the implementation or consummation of the Plan***.
>
> Except as expressly provided in the Plan, the Confirmation Order, or a separate order of the Bankruptcy Court, all Enjoined Parties are and shall be permanently enjoined, on and after the Effective Date, with respect to any Claims and Equity Interests, from directly or indirectly (i) commencing, conducting, or continuing in any manner any suit, action, or other proceeding of any kind (including any proceeding in a judicial, arbitral, administrative or other forum) against or affecting ***the Debtor or the property of the Debtor***, (ii) enforcing, levying, attaching (including any prejudgment attachment), collecting, or otherwise recovering, enforcing, or attempting to recover or enforce, by any manner or means, any judgment, award, decree, or order ***against the Debtor or the property of the Debtor***, (iii) creating, perfecting, or otherwise enforcing in any manner, any security interest, lien or encumbrance of any kind ***against the Debtor or the property of the Debtor***, (iv) asserting any right of setoff, directly or indirectly, against any obligation due to the ***Debtor or against property or interests in property of the Debtor***, except to the limited extent permitted under Sections 553 and 1141 of the Bankruptcy Code, and (v) ***acting or proceeding in any manner, in any place whatsoever, that does not conform to or comply with the provisions of the Plan.***

> The injunctions set forth herein shall extend to, and apply to any act of the type set forth in any of clauses (i)-(v) of the immediately preceding paragraph against any successors of the Debtor, including, ***but not limited to, the Reorganized Debtor, the Litigation Sub-Trust, and the Claimant Trust and their respective property and interests in property***. (Emphasis added.)

The Plan had a defined term for "Enjoined Parties," at Article I.B.56 that read as follows:

> "**Enjoined Parties**" means (i) all Entities who have held, hold, or may hold Claims against or Equity Interests in the Debtor (whether or not proof of such Claims or Equity Interests has been filed and whether or not such Entities vote in favor of, against or abstain from voting on the Plan or are presumed to have accepted or deemed to have rejected the Plan), (ii) James Dondero ("Dondero"), (iii) any Entity that has appeared and/or filed any motion, objection, or other pleading in this Chapter 11 Case regardless of the capacity in which such Entity appeared and any other party in interest, (iv) any Related Entity, and (v) the Related Persons[17] of each of the foregoing.

Simply stated, the injunctions were ***not*** a release, or absolution of liability, or exculpation *per se*, but were, rather, an equitable device aimed at: (a) enforcing the discharge of the Debtor; (b) protecting the Debtor's property dealt with by the Plan; and (c) preventing interference with implementation of the Plan. It was directed to claimants, equity interest holders, those who had participated in the Chapter 11 Case (including Mr. Dondero) and parties related to them. In sum—similar to so many Chapter 11 plans that this court sees—this provision was "belts and suspenders" to the Plan discharge and was essentially a ***policing mechanism to deter actions in violations of the discharge or otherwise inconsistent with the Plan***.

Gatekeeper Provisions. The Plan set forth gatekeeper provisions in the fourth paragraph of Article IX.F, although the gatekeeper provision did not use this title. This provision was very

[17] "Related Entity" and "Related Persons" were defined terms under the Plan, but the definitions will not be set forth herein, because they are not deemed relevant to the court's analysis.

much part and parcel to the Injunctions (which explains why it is located in the same section of the Plan). The provision stated:

> Subject in all respects to ARTICLE XII.D, no Enjoined Party may commence or pursue a claim or cause of action of any kind against any Protected Party ***that arose or arises from or is related to the Chapter 11 Case, the negotiation of the Plan, the administration of the Plan or property to be distributed under the Plan, the wind down of the business of the Debtor or Reorganized Debtor, the administration of the Claimant Trust or the Litigation Sub-Trust, or the transactions in furtherance of the foregoing*** without the Bankruptcy Court (i) first determining, after notice and a hearing, that such claim or cause of action represents a colorable claim of any kind, including, but not limited to, negligence, bad faith, criminal misconduct, willful misconduct, fraud, or gross negligence against a Protected Party and (ii) specifically authorizing such Enjoined Party to bring such claim or cause of action against any such Protected Party; provided, however, the foregoing will not apply to a claim or cause of action against Strand or against any Employee other than with respect to actions taken, respectively, by Strand or by such Employee from the date of appointment of the Independent Directors through the Effective Date. ***The Bankruptcy Court will have sole and exclusive jurisdiction to determine whether a claim or cause of action is colorable and, only to the extent legally permissible and as provided for in ARTICLE XI, shall have jurisdiction to adjudicate the underlying colorable claim or cause of action***. (Emphasis added.)

The Plan had a defined term for “Protected Parties” as follows:

> “**Protected Parties**” means, collectively, (i) the Debtor and its successors and assigns, direct and indirect majority-owned subsidiaries, and the Managed Funds, (ii) the Employees, (iii) Strand, (iv) the Reorganized Debtor, (v) the Independent Directors, (vi) the Committee, (vii) the members of the Committee (in their official capacities), (viii) the Claimant Trust, (ix) the Claimant Trustee, (x) the Litigation Sub-Trust, (xi) the Litigation Trustee, (xii) the members of the Claimant Trust Oversight Committee (in their official capacities), (xiii) New GP LLC, (xiv) the Professionals retained by the Debtor and the Committee in the Chapter 11 Case, (xv) the CEO/CRO; and (xvi) the Related Persons of each of the parties listed in (iv) through (xv); provided, however, that, for the avoidance of doubt, none of James Dondero, Mark Okada, NexPoint Advisors, L.P. (and any of its subsidiaries and managed entities), the Charitable Donor Advised Fund, L.P. (and any of its subsidiaries, including CLO Holdco, Ltd., and managed entities), Highland CLO Funding, Ltd. (and any of its subsidiaries, members, and managed entities), NexBank, SSB (and any of its subsidiaries), Highland Capital Management Fund Advisors, L.P. (and any of its subsidiaries and managed entities), the Hunter Mountain Investment Trust (or any trustee acting for the trust), the Dugaboy

> Investment Trust (or any trustee acting for the trust), or Grant Scott is included in the term "Protected Party."

Notably, the list of "Protected Parties" was not identical to the list of "Exculpated Parties." Namely, the "Protected Parties" list included several parties that were not even in existence prior to confirmation—such as the Claimant Trustee, Claimant Trust Oversight Board, and Litigation Trustee. In any event, simply put, the Gatekeeper Provision was somewhat of a tool to deal with any future, potential lawsuits that might be deemed to run afoul of the Injunctions. It did not effectuate a release or an absolution of any liability. Rather, as the "gatekeeper" nickname implies, it simply provided that a plaintiff would have to ***ask*** the gatekeeper before bringing a claim. No one would be allowed to bring a claim against a defined universe of "Protected Parties" without first asking the bankruptcy court. The bankruptcy court would have to determine, after notice, that such claim or cause of action represents a colorable claim against a Protected Party and specifically authorize such plaintiff to bring such claim against any such Protected Party. If the bankruptcy court were to deny permission, then, presumably, such denial could be appealed.

The Confirmation Order addressed Exculpation, the Injunctions, and the Gatekeeper Provisions at length at pages 48-59.

V. THE RELIEF SOUGHT IN THE MOTION TO CONFORM PLAN

As noted earlier, in the *Motion*, the Reorganized Debtor proposes that only one change is needed to make the Plan compliant with the Fifth Circuit's ruling: narrow the defined term for "Exculpated Parties" to read as follows:

> "Exculpated Parties" means, collectively, (i) the Debtor, (ii) the Independent Directors, (iii) the Committee, and (iv) members of the Committee (in their official capacities).

The Reorganized Debtor states that this one simple revision of this defined term "directly addresses all instances of exculpation deemed by the Fifth Circuit to violate section 524(e) of the Bankruptcy Code, and no other changes" are required to conform the Plan and Confirmation Order to the Final Fifth Circuit Opinion.[18]

The Funds' Opposition. The Funds support the revision of the defined term "Exculpated Parties," as proposed by the Reorganized Debtor, but they argue that the defined term "Protected Parties" must likewise be revised to "fully implement[ ] the mandate of the Fifth Circuit . . . ." [19] The Funds point to their Motion for Rehearing filed at the Fifth Circuit, wherein they expressed concern that "the Court's statement that the injunction and gatekeeper provisions are 'perfectly lawful,' might be argued to mean that the injunction and gatekeeper provisions – without any tailoring – are allowed to stand."[20] The Funds specifically asked the Fifth Circuit panel to revise its opinion to clarify and "to confirm the Court's holding that the impermissibly exculpated parties are similarly struck from the protections of the injunction and gatekeeper provisions of the Plan (in other words, that such parties cannot constitute 'Protected Parties'), such that the injunction and gatekeeper provisions extend only to Highland Capital, the Committee and its members, and the Independent Directors."[21] The Funds' argue that the fact that the panel granted the Motion for Rehearing and removed the "perfectly lawful" sentence (replacing it with the sentence noted above) and otherwise left the language unchanged means that the panel agreed with the Funds' interpretation of the Initial Fifth Circuit Opinion that "the parties protected by the injunction and

[18] DE # 3503, ¶ 11.
[19] DE # 3539, ¶ 3.
[20] DE # 3539, ¶ 5.
[21] DE # 3539, Exhibit B thereto, at ¶ 3.

gatekeeper provisions (the Protected Parties) must similarly be limited to the Properly Exculpated Parties – Highland, the Committee and its members, and the Independent Directors."[22] Accordingly, the Funds request that, in addition to narrowing the defined term "Exculpated Parties," the bankruptcy court order a similar narrowing of the defined term "Protected Parties" to read:

> "Protected Parties" means, collectively, (i) the Debtor, (ii) the Independent Directors, (iii) the Committee, and (iv) members of the Committee (in their official capacities).[23]

Dugaboy's Opposition. Dugaboy filed a short Joinder simply adopting the arguments of the Funds.[24]

The Advisors' Opposition. The Advisors filed an Objection adopting the Funds' Response but requesting two additional revisions to the Plan.[25] First, the Advisors proposed fully deleting the provision in the Injunctions section (Plan, Art. IX.F., third para.) that "purports to enjoin claims against successors of the Debtor who are not entitled to limited qualified immunity under" the Final Fifth Circuit Opinion.[26] Second, the Advisors proposed "carv[ing] out from the gatekeeping provision of the injunction those suits that are expressly allowed by 28 U.S.C. § 959(a)," by "amend[ing] the fourth paragraph of Article IX.F of the Plan by excepting from the gatekeeping provisions actions that relate to the Independent Directors or Debtor 'carrying on business connected with [their] property' as provided in § 959(a)." With respect to the "carve out" request, the Advisors point to footnote 18 of the Final Fifth Circuit Opinion, which states, "[W]e also leave

[22] DE # 3539, ¶ 14.
[23] DE # 3539, ¶ 19.
[24] DE # 3540.
[25] DE # 3551.
[26] *Id.* at ¶ 6.

the applicability of *Barton*'s[27] limited statutory exception to the bankruptcy and district courts in the first instance."[28]

Highland's Reply. Highland replied to all of this by arguing that the Motion for Rehearing—and what the Funds asked for therein—is hugely significant. The Funds specifically requested, in their Motion for Rehearing, that the Fifth Circuit panel (a) limit the definition of "Protected Parties" in the same way that it did with respect to the parties entitled to exculpation, and (b) "tailor" the injunction and gatekeeper provisions, in order to confirm that the Fifth Circuit meant to narrow the parties covered by the injunctions and gatekeeper provisions of the Plan. The Fifth Circuit did none of those things when it granted the Motion for Rehearing; it simply deleted the sentence stating that the gatekeeper provisions and injunction are "perfectly lawful" and otherwise left its initial affirmance of the gatekeeper provisions and injunctions intact. Highland argues that "the Fifth Circuit . . . clarified that the Injunction was 'sound' but not 'perfectly lawful'" and that nothing in the Final Fifth Circuit Opinion supports the position that the Fifth Circuit intended to limit the Protected Parties that are protected by the Gatekeeper Provision from "harassing and frivolous litigation." Highland further argues that, since the Gatekeeper Provision is not a release, it does not implicate § 524(e), but is necessary to prevent harassment.

VI. RULING ON MOTION TO CONFORM PLAN

The court grants the request of the Reorganized Debtor, holding that the only thing that needs to be done in response to the Final Fifth Circuit Opinion and mandate is to change the defined term for "Exculpated Parties," at Art. I.B.62 of the Plan as follows:

---

[27] This is, of course, a reference to *Barton v. Barbour*, 104 U.S. 126 (1881).
[28] 48 F.4th at 439 n.18 (citing 28 U.S.C. § 959(a) "(allowing suit, without leave of the appointing court, if the challenged acts relate to the trustee or debtor in possession 'carrying on business connected with [their] property'")).

> "'Exculpated Parties' means, collectively, (i) the Debtor, (ii) the Independent Directors, (iii) the Committee, and (iv) the members of the Committee (in their official capacities)."

In so holding, this court has scoured the Final Fifth Circuit Opinion to be clear what language survived and to discern what the Court did or did not find problematic with the Plan Protections. In that regard, this court notes the following:

On Page 429, the Fifth Circuit states:

> We then turn to the merits, conclude the Plan exculpates certain non-debtors beyond the bankruptcy court's authority, and affirm in all other respects.[29]

On Page 432, the Court states:

> We do, however, agree with Appellants that the bankruptcy court exceeded its statutory authority under § 524(e) by exculpating certain non-debtors, and so we reverse and vacate the Plan only to that extent.[30]

On Page 435, the Fifth Circuit states, before launching into a discussion of the various type of Plan Protections:

> The bankruptcy court deemed the provisions legal, necessary under the circumstances, and in the best interest of all parties. We agree, but only in part. Though the injunction and gatekeeping provisions are sound, the exculpation of certain non-debtors exceeds the bankruptcy court's authority. We reverse and vacate that limited portion of the Plan. . . . In a Chapter 11 bankruptcy proceeding, ''discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.'' 11 U.S.C. § 524(e). Contrary to the bankruptcy court's holding, the exculpation here partly runs afoul of that statutory bar on non-debtor discharge by reaching beyond Highland Capital, the Committee, and the Independent Directors. *See Pacific Lumber,* 584 F.3d at 251–53. We must reverse and strike the few unlawful parts of the Plan's exculpation provision.[31]

---

[29] 48 F.4th at 429.
[30] *Id.* at 432.
[31] *Id.* at 435.

On pages 437-438, in wrapping up its discussion of the Exculpation Provisions, the Fifth Circuit states:

> In sum, our precedent and § 524(e) require any exculpation in a Chapter 11 reorganization plan be limited to the debtor, the creditors' committee and its members for conduct within the scope of their duties, 11 U.S.C. § 1103(c), and the trustees within the scope of their duties, *see Baron*, 914 F.3d at 993. And so, excepting the Independent Directors and the Committee members, the exculpation of non-debtors here was unlawful. Accordingly, the other non-debtor exculpations must be struck from the Plan. *See Pacific Lumber*, 584 F.3d at 253.
>
> As it stands, the Plan's exculpation provision extends to Highland Capital and its employees and CEO; Strand; the Reorganized Debtor and HCMLP GP LLC; the Independent Directors; the Committee and its members; the Claimant Trust, its trustee, and the members of its Oversight Board; the Litigation Sub-Trust and its trustee; professionals retained by the Highland Capital and the Committee in this case; and all ''Related Persons.'' Consistent with § 524(e), we strike all exculpated parties from the Plan except Highland Capital, the Committee and its members, and the Independent Directors.[32]

On page 438, immediately after the previously quoted language, the next section of the Final Fifth Circuit Opinion has a subheading "Injunction & Gatekeeper Provisions," and then states:

> ***We now turn to the Plan's injunction and gatekeeper provisions.*** Appellants object to the bankruptcy court's injunction as vague and the gatekeeper provision as overbroad. We are unpersuaded.[33]

Note that the bolded sentence above is the only new sentence in the Final Fifth Circuit Opinion, and it replaced a previous sentence that read: "The injunction and gatekeeper provisions are on the other hand, perfectly lawful."

[32] *Id.* at 437-38.
[33] *Id.* at 438 (emphasis added).

Finally, in the penultimate paragraph of the entire Final Fifth Circuit Opinion, the Fifth Circuit states:

> In sum, the Plan violates § 524(e), but only insofar as it exculpates and enjoins certain non-debtors. The exculpatory order is therefore vacated as to all parties except Highland Capital, the Committee and its members, and the Independent Directors for conduct within the scope of their duties. We otherwise affirm the inclusion of the injunction and the gatekeeper provisions in the Plan.

On balance, this court does not know how it could be clearer, that the Fifth Circuit was holding that the exculpations of certain parties violated section 524(e), but the other Plan Protections were "sound."[34]

Of course, this still begs the question: what might the Fifth Circuit have meant in replacing the sentence ***"The injunction and gatekeeper provisions are on the other hand, perfectly lawful"*** with the sentence "***We now turn to the Plan's injunction and gatekeeper provisions"***?[35]

It is certainly awkward for this court to attempt to be a mind-reader regarding editorial or wordsmithing decisions undertaken by the Fifth Circuit. All this court can be sure of is that the Fifth Circuit declined the Funds' request, in their Motion for Rehearing, to strike or modify the defined term "Protected Parties" (that pertains to the Gatekeeper Provision) so that it would be coterminous with the defined term "Exculpated Parties." The Fifth Circuit did not modify the Gatekeeper Provision or its applicable definition of "Protected Parties" in any way, let alone in the manner that the Funds requested. And the Fifth Circuit did not include anything in its Final Fifth Circuit Opinion to indicate that the panel agreed with the Funds' analysis.

---

[34] *Id.* at 435.
[35] *Id.* at 438.

Moreover, limiting the definition of "Protected Parties" to be coterminous with the defined term "Exculpated Parties" would mean that the Gatekeeper Provision would have no effect on any conduct that occurs after the Plan Effective Date. Why? ***Because the persons included in the defined term "Exculpated Parties"—as now limited by the Fifth Circuit's ruling to include only the Debtor, the UCC, the UCC members, and Independent Directors—are all gone now.*** They all ceased to exist on the Effective Date. Additionally, the Debtor would not even need a Gatekeeper Provision for pre-Effective Date conduct because the Debtor was discharged. The Gatekeeper Provision is largely forward-looking, to prevent interference with post-Effective-Date management as they consummate the Plan, wind down the assets, and administer the Claimant Trust and the Litigation Sub-Trust. As noted, the defined term for "Protected Parties" includes several parties that did not even exist pre-confirmation such as the Claimant Trustee, Claimant Trust Oversight Board, and Litigation Trustee. It is mostly a tool to deal with any future, potential lawsuits that might be deemed to run afoul of Plan implementation. The Gatekeeper Provision did not effectuate a release or an absolution of any liability. Rather, as the "gatekeeper" nickname implies, it simply provided that a plaintiff would have to ***ask*** the gatekeeper before bringing a claim against the defined universe of "Protected Parties." If such a request is made, the bankruptcy court will determine, after notice, whether such claim or cause of action represents a colorable claim against a Protected Party and specifically authorize such plaintiff to bring such claim against any such Protected Party. If the bankruptcy court denies permission, then, presumably, such denial could be appealed.

The bankruptcy court humbly suggests that the Fifth Circuit well understood all of this. Perhaps they deleted the one sentence out of concern that there might be something in the Injunction Provisions that ran afoul of the new, narrowed defined term for "Exculpated Parties"—

for example, the catchall clause at Article IX.F(v) of the Injunction Provision. Specifically, that catchall clause, appearing after the injunctions of all sorts of conduct ***against the Debtor*** or its property, also enjoins parties from "(v) ***acting or proceeding in any manner, in any place whatsoever, that does not conform to or comply with the provisions of the Plan."*** Perhaps the Fifth Circuit thought this injunctive language was a little vague or broad, but it had fixed any problem with it, by making clear that no one was absolved from any liability except the Debtor, the UCC, the UCC members, and the Independent Directors. The Fifth Circuit had fixed any problem with the cause by ruling that the defined term "Exculpated Parties" was too broad.

But perhaps the Fifth Circuit was simply making a stylistic edit—maybe they thought the words "perfectly lawful" may have sounded a bit too rosy or glowing, with regard to gatekeeper provisions generally, and they did not want to suggest that they had blessed them for every plan in the future, no matter what the facts and circumstances were. Perhaps the word "sound" seemed more measured and case-specific than the words "perfectly lawful."

In any event, in light of the Fifth Circuit keeping intact, in its Final Fifth Circuit Opinion, the language that the "the injunction and gatekeeping provisions are sound," this court sees no need to tailor those provisions in any manner. This tailoring request was made to the Fifth Circuit in the Motion for Rehearing, and they declined.

Finally, with regard to the Advisors' request that this court delete the provision in the Injunctions section (Plan, Art. IX.F., third para.) that "purports to enjoin claims against successors of the Debtor who are not entitled to limited qualified immunity" pursuant to the Final Fifth Circuit Opinion and "carve out from the gatekeeping provision . . . those suits that are expressly allowed by 28 U.S.C. § 959(a)," the bankruptcy court declines this request. This court does not read footnote 18 of the Fifth Circuit's Final Opinion, which states, "[W]e also leave the applicability of

Barton's[36] limited statutory exception to the bankruptcy and district courts in the first instance,"[37] as necessitating any modification to the Plan whatsoever.

VII. CONCLUSION

The court grants the *Motion* and orders that one change be made to the Plan to conform it to the mandate of the Fifth Circuit: revise the definition of "Exculpated Parties" as proposed in the *Motion* and no more.

 # # # END OF MEMORANDUM OPINION AND ORDER # # #

---

[36] This is, of course, a reference to *Barton v. Barbour*, 104 U.S. 126 (1881).
[37] 48 F.4th at 439 n.18 (citing 28 U.S.C. § 959(a) "(allowing suit, without leave of the appointing court, if the challenged acts relate to the trustee or debtor in possession 'carrying on business connected with [their] property'")).

Nondischargeability of Corporate Debt in Subchapter V

Cantwell-Cleary Co. Inc. v. Cleary Packaging L.L.C.
(In re Cleary Packaging L.L.C.), 36 F.4th 509 (4th Cir. 2022)

Avion Industries, LLC v. GFS Indus., LLC
(In re GFS Industries, LLC), 647 B.R. 337 (Bankr. W.D. Tex. 2022)

36 F.4th 509
United States Court of Appeals, Fourth Circuit.

IN RE: CLEARY PACKAGING, LLC, Debtor.
Cantwell-Cleary Co., Inc., Plaintiff - Appellant,
v.
Cleary Packaging, LLC, Defendant - Appellee.
Public Justice Center; Legal Aid Justice Center; Mountain State Justice; North Carolina Justice Center; Casa; Centro de los Derechos del Migrante; National Black Worker Center; National Employment Law Project; Farm Labor Organizing Committee, AFL-CIO; United States of America, Amici Supporting Appellant.

No. 21-1981
|
Argued: March 10, 2022
|
Decided: June 7, 2022

Synopsis
Background: Judgment creditor filed adversary complaint against debtor, a limited liability company (LLC) that had elected to proceed under Subchapter V of Chapter 11 as a "small business debtor," seeking declaration that $4.7 million debt arising from its state-court judgment for intentional interference with contracts and tortious interference with business relations was nondischargeable as a debt for "willful and malicious injury." Debtor moved to dismiss for failure to state a claim. The United States Bankruptcy Court for the District of Maryland, Michelle M. Harner, J., 630 B.R. 466, granted motion. Judgment creditor appealed, and its appeal was certified for direct appeal to the Fourth Circuit.

Addressing a matter of apparent first impression for the court, the Court of Appeals, Niemeyer, Circuit Judge, held that the discharge exceptions in Subchapter V of Chapter 11 apply to both individual debtors and corporate debtors.

Reversed and remanded with instructions.

Procedural Posture(s): On Appeal; Motion to Dismiss for Failure to State a Claim; Motion for Summary Judgment; Request for Declaratory Judgment.

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

***511** Appeal from the United States Bankruptcy Court for the District of Maryland, at Baltimore. Michelle W. Harner, Bankruptcy Judge. (21-10765; 21-00056)

Attorneys and Law Firms

ARGUED: Justin Philip Fasano, MCNAMEE HOSEA, P.A., Greenbelt, Maryland, for Appellant. Robert Joel Branman, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Amicus United States. Paul Sweeney, YUMKAS, VIDMAR, SWEENEY & MULRENIN, LLC, Columbia, Maryland, for Appellee. ON BRIEF: Steven L. Goldberg, MCNAMEE HOSEA, P.A., Greenbelt, Maryland, for Appellant. James R. Schraf, YUMKAS, VIDMAR, SWEENEY & MULRENIN, LLC, Columbia, Maryland, for Appellee. Michael R. Abrams, Murnaghan Appellate Advocacy Fellow, PUBLIC JUSTICE CENTER, Baltimore, Maryland, for Amici The Public Justice Center; The Legal Aid Justice Center; Mountain State Justice; The North Carolina Justice Center; CASA; Centro de los Derechos del Migrante; The Farm Labor Organizing Committee, AFL-CIO; The National Black Worker Center; and The National Employment Law Project. David A. Hubbert, Deputy Assistant Attorney General, Joan I. Oppenheimer, Tax Division, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C.; Erek L. Barron, United States Attorney, OFFICE OF THE UNITED STATES ATTORNEY, Baltimore, Maryland, for Amicus United States.

Before NIEMEYER, MOTZ, and KING, Circuit Judges.

Opinion

Reversed and remanded with instructions by published opinion. Judge Niemeyer wrote the opinion, in which Judge Motz and Judge King joined.

NIEMEYER, Circuit Judge:

When Cleary Packaging, LLC, filed a petition in bankruptcy under Subchapter V of Chapter 11 as a "small business debtor," seeking to discharge a $4.7 million judgment that Cantwell-Cleary Co., Inc. had obtained against it for intentional interference with contracts and tortious interference with business relations, Cantwell-Cleary opposed the effort. It argued that 11 U.S.C. § 1192(2), which falls within Subchapter V, provides that small business ***512** debtors are not entitled to discharge "any debt ... of the kind specified in section 523(a) of this title," *id.* § 1192(2), and that § 523(a) in turn lists 21 categories of debt that are non-dischargeable, including debts "for willful and malicious injury by the debtor to another entity or to the property of another entity," *id.* § 523(a)(6). Cleary Packaging argued, however, that because § 523(a)'s list of exceptions to dischargeability is applicable only to "individual debtor[s]," its $4.7 million debt as the debt of a corporation was not covered by the exception contained in § 1192(2) and therefore was indeed dischargeable. [1]

Cantwell-Cleary responded that because the language of § 1192(2) incorporates *only the list* of debts — debts "*of the kind* specified in section 523(a)" — and *not the class of debtors* addressed by § 523(a), the $4.7 million debt is non-dischargeable as a debt for willful and malicious injury.

1 While, for convenience, we use the terms "individual debtor" and "corporate debtor" in a binary fashion, we recognize that Cleary Packaging is a limited liability company under Maryland law. The Bankruptcy Code, however, includes within its definition of "corporation" limited liability companies. *See* 11 U.S.C. § 101(9)(A).

The bankruptcy court, in a nicely crafted opinion, agreed with Cleary Packaging and concluded that its $4.7 million debt was indeed dischargeable, reasoning that the exceptions to dischargeability that were incorporated into § 1192(2) from § 523(a) applied only to *individual* debtors. The court relied heavily on the reasoning of *Gaske v. Satellite Restaurants Inc. Crabcake Factory USA (In re Satellite Restaurants Inc. Crabcake Factory USA)*, 626 B.R. 871 (Bankr. D. Md. 2021), which was dismissed on appeal. While the question is a close one, we nonetheless disagree with the bankruptcy court, as explained herein. Accordingly, we reverse the court's ruling and remand.

I

Cantwell-Cleary is a Maryland corporation engaged as a wholesaler of office-related products, particularly packaging supplies, janitorial and sanitation supplies, and paper products. Vincent Cleary Jr., who was on the board of directors of Cantwell-Cleary and its former president and CEO, left the company in June 2018 following a long-running family dispute involving divorce proceedings and internal disagreements over control of the company. He thereafter formed Cleary Packaging, LLC. He took with him numerous employees covered by noncompetition agreements and sensitive customer information and began the new business in competition with Cantwell-Cleary. Shortly thereafter, Cantwell-Cleary commenced an action in the Circuit Court for Anne Arundel County, Maryland, for intentional interference with contracts, tortious interference with business relations, and related claims. On the jury's verdict in favor of Cantwell-Cleary, the state court entered judgment in January 2021 against Cleary Packaging and Vincent Cleary Jr. in the aggregate amount of $4,715,764.98.

Cleary Packaging thereafter filed a petition under Chapter 11 of the Bankruptcy Code, electing to proceed under Subchapter V as a small business enterprise. In its plan for reorganization, it proposed to pay Cantwell-Cleary 2.98 percent of its judgment in biannual installments over a period of five years, for a total of $140,489.77. If the plan were to be approved, the remainder of Cleary Packaging's debt to Cantwell-Cleary would be discharged.

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

Cantwell-Cleary filed a complaint in the bankruptcy court, seeking a declaratory judgment that the $4.7 million judgment is not dischargeable under ***513** 11 U.S.C. §§ 1192(2) and 523(a). It also sought, by motion for summary judgment, a judgment giving preclusive effect in the bankruptcy court to its state judgment. On Cleary Packaging's motion, the bankruptcy court dismissed Cantwell-Cleary's declaratory judgment action, finding that the discharge exceptions in § 1192(2) and § 523(a) do not apply to *corporate* debtors because of limiting language in § 523(a). Specifically, it held that the § 523(a) list of exceptions to dischargeability applies only to *individual* debtors. Because Cleary Packaging was not an individual, but rather a corporation (in this case, a limited liability company), its debt was therefore not excepted from discharge under § 523(a). Consequently, the court also dismissed Cantwell-Cleary's motion for summary judgment as moot.

On Cantwell-Cleary's motion, the bankruptcy court certified a direct appeal to this court of its "Section 523 Opinion and Order," pursuant to 28 U.S.C. § 158(d)(2)(A)(i), and we authorized the appeal by order dated September 8, 2021. The sole question on appeal, therefore, is whether Cleary Packaging, as a Subchapter V corporate debtor, can discharge its $4.7 million debt to Cantwell-Cleary "for willful and malicious injury."

II

In filing its Chapter 11 petition, Cleary Packaging elected to proceed under Subchapter V, and accordingly its discharge of debts is specifically governed by 11 U.S.C. § 1192(2). That section provides: "If the plan of the debtor is confirmed ... the court shall grant the debtor a discharge of all debts ... except any debt ... of the kind specified in section 523(a) of this title." Section 523(a), which applies to a range of bankruptcy code discharge provisions, including § 1192, provides that discharges in those specified sections "do[ ] not discharge an *individual debtor* from" a list of 21 types of debt, including a debt "for willful and malicious injury," *implying* that such exceptions do not apply to corporate debtors. 11 U.S.C. § 523(a) (emphasis added).

The parties do not dispute that Cleary Packaging's $4.7 million debt created by entry of the state judgment was "for willful and malicious injury" and therefore would qualify as the type of debt that § 523(a) makes non-dischargeable. *See* 11 U.S.C. § 523(a)(6). Rather, the dispute centers on conflicting interpretations of the two relevant provisions — § 1192(2) and § 523(a) — relating to the *kind of debtor* subject to the discharge exceptions listed in § 523(a). Cleary Packaging, focusing on § 523(a), argues that it limits § 1192(2) discharges with respect to the 21 categories of debt only as to *individual debtors*, and therefore corporate debts of the kind listed remain dischargeable. Cantwell-Cleary, on the other hand, focuses on § 1192(2), which applies to both individual and corporate debtors, and argues that the section excludes from discharge *debts of the kind* listed in § 523(a), regardless of the *class of debtor*, whether individual or corporate. Because § 1192(2) is the specific provision governing discharges in Subchapter V proceedings, Cantwell-Cleary argues

that if there is any inconsistency, we should give § 1192(2) precedence over the more general § 523(a) and thereby except Cleary Packaging's $4.7 million debt from a discharge, as it is a type of debt listed in § 523(a).

While we recognize a certain lack of clarity in the relationship between § 1192(2) and § 523(a), we conclude, based on our textual review, the provisions' context in the Bankruptcy Code, and practical and equitable considerations, that Cantwell-Cleary makes the more persuasive argument.

***514** A

First, by way of background, we note that in a traditional Chapter 11 proceeding, the debtor submits and the court approves a plan of reorganization for the distribution of the debtor's estate. And when the creditors withhold their consent, any such plan must be fair and equitable in that it must comply with priority rules that establish a hierarchy of creditor classes for the order in which each class of creditor is to be paid. Thus, higher priority creditors are paid in full before payment is made to lower priority creditors. The rule began with judicial construction and, beginning in 1978, was included in the Bankruptcy Code. *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988). Known as the "absolute priority rule," it requires that any plan, to which creditors have not consented, must provide that "a dissenting class of unsecured creditors [be paid] in full before any junior class can receive [payment]." *Id.* (citation omitted); *In re Maharaj*, 681 F.3d 558, 562 (4th Cir. 2012); 11 U.S.C. § 1129(b)(2)(B)(ii). And, as a general matter, any non-consensual plan violating the absolute priority rule may not be approved, nor may a discharge of debts be granted. *See* 11 U.S.C. § 1129(b)(2)(B)(ii). It can be readily recognized, however, that this strict priority rule could preclude reorganizations in which continuing management of the bankruptcy estate by a business's owners would be essential to a successful reorganization because such owners' retention of estate property would violate the priority rule.

Apparently in response to the problem, at least in part, Congress enacted Subchapter V in the Small Business Reorganization Act of 2019, Pub. L. No. 116–54, 133 Stat. 1079, to streamline reorganizations for small business debtors — defined during the relevant time period as those debtors whose debt is not more than $7.5 million, *see* 11 U.S.C. § 1182(1) (2020). One of the main features of a Subchapter V proceeding is its authorization of plans that are not consented to by creditors and that depart from the absolute priority rule of § 1129(b). Under the governing rules of a Subchapter V proceeding, the bankruptcy court need only find that such a plan provide that all of the debtor's projected disposable income is paid to creditors for a 3-to 5-year period and that it be feasible. 11 U.S.C. § 1191(c)(2)(A) and (3). Thus, the owners of a Subchapter V debtor are able to retain their equity in the bankruptcy estate despite creditors' objections.

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

Subchapter V also provides specific rules for discharge, requiring a court to grant discharge of all debts after approval of the plan except (1) any debt payable *after* the 3- to 5-year period specified for payment, and (2) any debt "of the kind specified in section 523(a)." 11 U.S.C. § 1192.

B

We now turn to the text of § 1192(2), which specifically governs Cleary Packaging's discharge, to determine the debts dischargeable under Subchapter V. First, we point out that § 1192(2) provides for granting *debtors* a discharge of all debts, subject to stated exceptions. For the purpose of Subchapter V, the term "debtor" was defined during the relevant time period to mean "a *person* engaged in commercial or business activities" that has debt of not more than $7.5 million. 11 U.S.C. § 1182(1) (2020) (emphasis added). "[P]erson" is in turn defined to include both individuals and corporations, *see id.* § 101(41), and "corporation[s]" include limited liability companies, *id.* § 101(9)(A). We thus conclude that § 1192(2) provides for the discharge of ***515** debts for *both* individual and corporate debtors.

Still, even though § 1192(2) applies to both individual and corporate debtors, the question remains whether the exception to such discharges — based on § 1192(2)'s reference to § 523(a) — applies to both individuals and corporations or to only individuals. And that question arises because the introductory language in § 523(a) limits its discharge exceptions to *individual* debtors. Specifically, § 523(a) provides that § 1192, along with five other discharge sections of the Bankruptcy Code, "does not discharge *an individual debtor*" from a list of 21 specified debts, including "any debt ... for willful and malicious injury,"11 U.S.C. § 523(a)(6) (emphasis added), implying that corporations are not subject to the discharge exceptions.

To address the question, we begin by focusing on § 1192(2) as the provision specifically governing discharges in a Subchapter V proceeding and on the scope of its incorporation of § 523(a). Section 1192(2) excepts from discharge "any *debt ... of the kind* specified in section 523(a)." 11 U.S.C. § 1192(2) (emphasis added). The section's use of the word "debt" is, we believe, decisive, as it does not lend itself to encompass the "kind" of *debtors* discussed in the language of § 523(a). This is confirmed yet more clearly by the phrase modifying "debt"— i.e., "of the kind." Thus, the combination of the terms "debt" and "of the kind" indicates that Congress intended to reference only the *list of non-dischargeable debts* found in § 523(a). As the U.S. Government's amicus brief notes, this interpretation of "of the kind" is in line "with the ordinary meaning of the word 'kind' as 'category' or 'sort.' " (Citing American Heritage Dictionary of the English Language (online ed.) (" '[a] group of individuals or instances sharing common traits; a category or sort' "); Merriam-Webster Dictionary (online ed.) (" 'a group united by common traits or interests: CATEGORY' ")). In short, while § 523(a) does provide that discharges under various sections, including § 1192 discharges, do not "discharge *an individual debtor* from any debt" of the kind listed, § 1192(2)'s

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

We add — to the extent that one might find tension between the language of § 523(a) addressing individual debtors and the language of § 1192(2) addressing both individual and corporate debtors — that the more specific provision should govern over the more general. *See, e.g., S.W. Ga. Farm Credit, Aca v. Breezy Ridge Farms, Inc. (In re Breezy Ridge Farms, Inc.)*, No. 09-1011, 2009 WL 1514671, at *2 (Bankr. M.D. Ga. May 29, 2009) ("If the two provisions may not be harmonized, then the more specific will control over the general" (quoting *Universal Am. Mortg. Co. v. Bateman (In re Bateman)*, 331 F.3d 821, 825 (11th Cir. 2003))). Thus, while § 523(a) references numerous discharge provisions of the Bankruptcy Code, § 1192(2) is the more specific, addressing only Subchapter V discharges.

C

The context of § 1192(2) within the Bankruptcy Code and the Bankruptcy Code's structure further support our interpretation. ***516** It is readily apparent from a review of different Bankruptcy Code chapters that Congress conscientiously defined and distinguished the kinds of debtors covered by each provision. For example, Chapter 7 discharges are explicitly limited to individuals, *see* 11 U.S.C. § 727(a)(1), as are Chapter 13 discharges, *see id.* §§ 109(e), 1328. More tellingly, as to traditional Chapter 11 proceedings, Congress explicitly distinguished the discharges of individual debtors from the discharges of corporate debtors in § 1141(d), excluding a different array of debts from discharge for each. *Compare id.* § 1141(d)(2), (5) (addressing the scope of discharge for individuals) *with id.* § 1141(d)(6) (addressing the scope of discharge for corporations). Yet Congress purposefully addressed both individual and corporate debtors when defining the right of discharge in Subchapter V proceedings. *Id.* § 1192.

Cleary Packaging's interpretation would also create difficulty in reconciling § 523(a) with § 1141(d)(6). Section 523(a) includes in its scope § 1141, just as it includes § 1192 and several other sections, and therefore under Cleary Packaging's interpretation, the list of exceptions to discharge in a traditional Chapter 11 proceeding would govern only individuals by reason of § 523(a)'s limiting language. Yet, § 1141 incorporates specified debts listed in § 523(a) to apply *to corporate debtors*, excluding from discharge debts "of a kind specified in paragraph (2)(A) or (2)(B) of section 523(a)." 11 U.S.C. § 1141(d)(6)(A). Cleary Packaging has been unable to reconcile

its method for applying § 523(a) to § 1192 with any consistency as to how it would apply § 523(a) to § 1141(d)(6).

Yet more telling is Congress's importation of language into Subchapter V from the conceptually similar Chapter 12 proceedings, which are limited to family farmers and family fishermen, whether they be individuals or corporations. *See* 11 U.S.C. § 101(18), (19A); *see also, e.g., In re Trepetin*, 617 B.R. 841, 848 (Bankr. D. Md. 2020) (recognizing that "[s]everal aspects of Subchapter V are premised on the provisions of chapter 12 of the Code for family farmers and fishermen").

In addressing the scope of discharge, Chapter 12 provides, in relevant part, that "the court shall grant the debtor a discharge of all debts provided for by the plan ... except any debt ... *of a kind specified in section 523(a)* of this title." 11 U.S.C. § 1228(a) (emphasis added). This language in Chapter 12 is virtually identical to the language included in § 1192(2).[2] Moreover, § 523(a) specifically references § 1228(a) discharges, just as it does § 1192 discharges. Yet, the courts construing the scope of § 1228(a) have concluded that § 1228(a)'s discharge exceptions apply *to both individual debtors and corporate debtors. See, e.g., Breezy Ridge Farms*, 2009 WL 1514671, at *1–2; *New Venture P'ship v. JRB Consol., Inc. (In re JRB Consol., Inc.)*, 188 B.R. 373 (Bankr. W.D. Tex. 1995). Interpreting language virtually identical to that in § 1192(2), the bankruptcy court in *JRB Consolidated* stated that "[t]he wording in § 1228(a)(2) describing 'debts of the kind' specified in § 523(a) does not naturally lend itself to also incorporate the meaning 'for debtors of the kind' referenced in § 523(a)." 188 B.R. at 374. Instead, it stated, "[d]ebts of the kind easily seems to be limited to the subparagraphs of § 523(a) which identify the types of debts which are eligible to be excepted from discharge." *Id.*; *see also Breezy Ridge Farms*, 2009 WL 1514671, at *2 (finding that Congress used the reference to ***517** § 523(a) in § 1228 "as shorthand to define the scope of a Chapter 12 discharge for corporations as well as individuals"). Thus, prior interpretations of § 1228(a) support our interpretation of § 1192(2)'s virtually identical language. *See Hall v. United States*, 566 U.S. 506, 519, 132 S.Ct. 1882, 182 L.Ed.2d 840 (2012) ("[I]dentical words and phrases within the same statute should normally be given the same meaning" (citations omitted)). To give different interpretations to the same language in the same statute would ignore the rationality of using the same language in describing a different proceeding of the Bankruptcy Code, as was done with the adoption of Subchapter V.

2 There is one inconsequential difference — § 1228(a) refers to debt "of *a* kind specified," while § 1192(2) refers to debt "of *the* kind specified."

Finally, our interpretation of § 1192(2) in Subchapter V makes particular sense when considering that subchapter's juxtaposition in Chapter 11 with traditional Chapter 11 provisions, reflecting its distinctive purpose within that Chapter. Congress enacted Subchapter V as part of the Small Business Reorganization Act of 2019 with the primary goal of simplifying Chapter 11 reorganizations for small businesses and reducing the administrative costs for those businesses. To

do so, Congress deliberately altered the general provisions of traditional Chapter 11 proceedings by, among other things, eliminating the absolute priority rule and limiting the applicability of § 1141(d) to Subchapter V proceedings. Section 1141(d), in particular, sets forth debts that are eligible for discharge in a traditional Chapter 11 proceeding, making distinctions between individual debtors and corporate debtors. *See* *Breezy Ridge Farms*, 2009 WL 1514671, at *2; *cf.* *JRB Consol.*, 188 B.R. at 374. In contrast, § 1192 provides benefits to small business debtors, regardless of whether they are individuals or corporations. Thus, an important purpose for Subchapter V would be frustrated were we to adopt Cleary Packaging's interpretation of §§ 1192(2) and 523(a), which would treat individuals and corporations differently.

And as to fairness and equity, it should be recognized that a Subchapter V proceeding involves a non-consensual plan — i.e., a "cram-down" proceeding — in which stakeholders in the bankruptcy estate are treated differently than they would be in traditional Chapter 11 proceedings under the absolute priority rule. Under a Subchapter V plan, owners of a debtor can retain ownership interests to continue conducting the reorganization at the expense of and over the objection of creditors. Given the elimination of the absolute priority rule, Congress understandably applied limitations on the discharge of debts to provide an additional layer of fairness and equity to creditors to balance against the altered order of priority that favors the debtor. To this end, *all Subchapter V debtors* are textually subject to the discharge limitations described in § 523(a), not just *individual* Subchapter V debtors. To make a distinction between individuals and corporations for how Subchapter V is applied would not only undermine that balance, but would also make no sense and indeed would create perverse incentives. But most importantly, it would violate the text of § 1192(2).

III

At bottom, while we recognize that the relationship between § 523(a) and § 1192 might be a bit discordant — or perhaps more accurately, clumsy — we find more harmony from following a close textual analysis and contextual review of § 1192(2) and thus conclude that it provides discharges to small business debtors, *whether they are individuals or corporations*, except with respect to the 21 kinds of debts listed in § 523(a). We would find it difficult to conceive of giving § 523(a) the additional ***518** role of defining *the debtors* covered by § 1192(2) in conflict with § 1192(2)'s own language. That function is actually and better carried out by § 1192, which is the specific provision governing discharges in Subchapter V proceedings and which applies to individual and corporate debtors alike. Finally, we conclude that our interpretation serves fairness and equity in circumstances where *a small business corporate debtor* in particular is given greater priority over creditors than would ordinarily apply and thus should not especially benefit from the discharge of debts incurred in circumstances of fraud, willful and malicious injury, and the other violations of public policy reflected in § 523(a)'s list of exceptions.

* * *

Accordingly, we reverse the bankruptcy court's certified order and remand the case for further proceedings, including consideration of Cantwell-Cleary's motion for summary judgment.

REVERSED AND REMANDED

All Citations

36 F.4th 509

End of Document © 2023 Thomson Reuters. No claim to original U.S. Government Works.

647 B.R. 337
United States Bankruptcy Court, W.D. Texas, San Antonio Division.

IN RE: GFS INDUSTRIES, LLC, Debtor.
Avion Funding, LLC, Plaintiff,
v.
GFS Industries, LLC, Defendant.

CASE NO. 22-50403-cag
|
ADV. NO. 22-05052-cag
|
Signed November 10, 2022

Synopsis
Background: Creditor filed complaint for determination of dischargeability of Chapter 11 debtor's debt. Debtor moved to dismiss.

Holdings: The Bankruptcy Court, Craig A. Gargotta, J., held that:

on issue of first impression, exceptions to discharge in bankruptcy apply to discharge under Subchapter V, but only as to individual debtors;

limits on dischargeability did not apply to Subchapter V debtor; and

discharge exceptions did not apply to confirmed nonconsensual plan.

Motion granted.

Procedural Posture(s): Motion to Dismiss for Failure to State a Claim.

Attorneys and Law Firms

***339** Btzalel Hirschhorn, Shiryak, Bowman, Anderson, Gill & Kadochnikov, LLP, Kew Gardens, NY, for Plaintiff.

Robert Chamless Lane, The Lane Law Firm, PLLC, Houston, TX, for Defendant.

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

ORDER GRANTING DEFENDANT GFS INDUSTRIES, LLC'S FIRST AMENDED RULE 12(b)(6) MOTION TO DISMISS PLAINTIFF'S COMPLAINT (ECF NO. 6)

CRAIG A. GARGOTTA, CHIEF UNITED STATES BANKRUPTCY JUDGE

Came on to be considered Defendant GFS Industries, LLC's First Amended Rule 12(b)(6) Motion to Dismiss Plaintiff's Complaint ("Motion to Dismiss") (ECF No. 6)[1]. The Motion to Dismiss seeks to dismiss with prejudice Plaintiff's Original Complaint for Determination of Dischargeability of Debt Pursuant to 11 U.S.C. § 523(a)(2) & (4) ("Complaint") (ECF No. 1). In response, Plaintiff Avion Funding, LLC filed Plaintiff's Opposition to Defendant's First Amended Rule 12(b)(6) Motion to Dismiss Plaintiff's Complaint ("Response") (ECF #7). The Court took the matter under advisement without the necessity of a hearing. For the reasons stated below, the Court GRANTS the Motion to Dismiss.

1 "ECF" denotes electronic filing docket number.

JURISDICTION

This Court has jurisdiction over the Motion to Dismiss pursuant to 28 U.S.C. § 1334(b). Plaintiff's dischargeability claims are deemed a core proceeding under 28 U.S.C. § 157(b)(2)(I). Venue is proper under 28 U.S.C. §§ 1408 and 1409. The statutory predicate for relief is Federal Rule of Civil Procedure ("Rule(s)") 12(b)(6), made applicable to this proceeding through Fed. R. Bankr. P. 7012 and Local Rule 7012. This matter is referred to this Court pursuant to the District Court's Order of Reference.

BACKGROUND

Debtor GFS Industries, LLC ("Debtor" or "GFS") provides cleaning and environmental services to commercial tenants. As a result of the COVID pandemic, GFS anticipated that the increased demand for sanitation and cleaning services would enable its business to grow. GFS attempted to expand its business to meet the forecasted demand. With the burden of increased administrative costs, GFS resorted to seeking funding through Merchant Cash Advances ("MCA"). Because MCAs require factoring of future account receivables at a discount, GFS was unable to service its operations without sufficient cash flow. Accordingly, GFS filed bankruptcy under the Subchapter V Chapter 11 provisions of Title 11, § 1181[2] *et seq*. on April 21, 2022.

2 Unless otherwise indicated, all section references are to Title 11 U.S.C.—— *et. seq*.

The instant adversary proceeding was filed by one of GFS's MCA lenders, Avion Funding, LLC (“Avion”). Avion alleges that GFS made material misrepresentations concerning whether a bankruptcy filing was imminent and failed to disclose the existence of other, more senior, MCA lenders from which GFS obtained funding. As a result of these misrepresentations and ***340** nondisclosures, Avion claims that it has been harmed and seeks relief in the form of a declaration that the debt GFS owes to Avion be deemed nondischargeable.

LEGAL STANDARD

Rule 12(b)(6)

To survive a Rule 12(b)(6) motion to dismiss, a complaint must contain sufficient facts to state a claim to relief that is plausible on its face. ***Gonzalez v. Kay***, 577 F.3d 600, 603 (5th Cir. 2009) (quoting ***Ashcroft v. Iqbal***, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009)). A claim for relief is plausible on its face “when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.” ***Iqbal***, 556 U.S. at 678, 129 S.Ct. 1937. In reviewing whether the complaint sufficiently states a claim on which relief may be granted, the Court must accept all well-pleaded facts as true and view those facts in the light most favorable to the plaintiff. ***Thompson v. City of Waco, Tex.***, 764 F.3d 500, 502–03 (5th Cir. 2014). A court should dismiss a complaint if it appears beyond doubt that the plaintiff can prove no set of facts which would entitle him to relief. ***Bell Atl. Corp. v. Twombly***, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007). In sum, a Rule 12(b)(6) motion to dismiss “may be granted either because a legal remedy based on the alleged facts does not exist or because the facts as alleged, even if true, do not satisfy the legal requirements of the pleaded cause of action. ***In re Rosetti,*** No. 07-04063-DML, 2007 WL 2669265 (Bankr. N.D. Tex. September 6, 2007).

Rule 9

Though most causes of action are subject to Rule 8(a)’s pleading standard, Rule 9(b) establishes a heightened pleading standard for cases in which the Plaintiff alleges fraud. Under Rule 9(b), fraud claims must be alleged with particularity concerning the circumstances of the fraud. Fed. R. Civ. P. 9(b). Rule 9(b) requires the plaintiff to “plead the who, what, when, where, and why as to the fraudulent conduct.” ***Life Partner Creditors’ Tr. v. Crowley (Matter of Life Partners Holdings, Inc.),*** 926 F.3d 103, 117 (5th Cir. 2019).

The Court notes that the Motion to Dismiss makes no mention of and provides no argumentation on Rule 9’s heightened pleading standard or whether the Complaint satisfies that standard. Instead, the Motion to Dismiss argues that the Complaint does not measure up to the standards set forth in

Rule 8. Rule 9, rather than Rule 8, is the measuring stick in cases in which fraud is alleged. Fed. R. Civ. P. 9 ("In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake"). Here, the Court must apply Rule 9 because the Complaint alleges fraudulent behavior in all six counts. Consequently, any determinations as to factual sufficiency are made using the standard set forth in Rule 9.

DISCUSSION

In its Complaint, Avion alleges six causes of action under §§ 523, 727, and 1141 that all arise from the same operative facts. The Motion to Dismiss argues that Avion cannot prevail as a matter of law because none of the statutory predicates for the relief sought apply to GFS as a corporate Subchapter V debtor. Conversely, Avion urges that the plain language of the statutes makes these adversary claims cognizable.

In 2019, Congress passed the Small Business Debtor Reorganization Act from which Subchapter V of Chapter 11 was born. Commentators and courts have determined that the legislation's purpose is ***341** to provide recourse to small business owners and individual debtors without the attendant costs and restraints imposed in traditional Chapter 11 cases. Notably, Subchapter V cases do not require the payment of US Trustee fees, filing of a disclosure statement, or application of the absolute priority rule. These changes have largely proven beneficial to those debtors who are able to take advantage of them.

Given the novelty of Subchapter V, courts continue facing important issues regarding its interpretation and implementation. As such, case law concerning the provisions of Subchapter V is lacking. Thus, the Court observes an important threshold issue present in this case: whether a corporate debtor can be granted a discharge in a Subchapter V case.[3] While the answer may seem obvious and unworthy of discussion, the newness of Subchapter V bares a close analysis of its provisions and their application. Indeed, dischargeability actions are moot if the debtor is not eligible for discharge or has voluntarily waived its discharge. In summary form, the validity of Avion's causes of action rely on the subtle—yet critical—assumption that GFS is entitled to a discharge at all. The Court will address the threshold discharge issue before analyzing each cause of action in turn.

3 The Court recognizes that another interesting and unsettled issue underlies the issues presented: whether transactions classified as "Merchant Cash Advances" like the one here are considered sales or loans. In its briefing, Avion describes the transaction as a sale of receivables, while simultaneously seeking to have its "debt" deemed nondischargeable. With

WESTLAW © 2023 Thomson Reuters. No claim to original U.S. Government Works.

MCAs becoming increasingly common, the Court may be presented with this issue at some point in the future but will not answer the question in this decision.

I. ***Does a Corporate Subchapter V Debtor Receive a Discharge of its Debts?***

There are two statutes that control the discharge of debts for a corporate Subchapter V debtor: §§ 1141(d) and 1192. The answer to which statute controls a specific debtor's discharge is based on the character of that debtor's confirmed plan. If the plan is consensual, § 1141(d) governs. If, as here, the plan is nonconsensual and thus is confirmed under § 1191(b), then § 1192 controls the fate of the Subchapter V debtor's discharge. After reviewing the language in § 1192, the Court observes that the plain language of the statute contemplates granting corporate Subchapter V debtors a discharge of its debts.

Section 1192 states, "[i]f the plan of the debtor is confirmed under section 1191(b) of this title...the court shall grant the debtor a discharge of all debts provided in section 1141(d)(1)(A) of this title, and all other debts allowed under section 503 of this title and provided for in the plan." The operative statute uses the term "debtor" to describe those who receive discharges under § 1192. The term "debtor" is defined in § 101(13) as a "person or municipality concerning which a case under this title is commenced." The term "person" is also defined in § 101 at subsection (41) as including "individual, partnership, and corporation." Based on this language, it is evident that the term "debtor" in § 1192 encompasses corporations, not just individuals.

Notably, § 1192 does not contain a carve-out provision for non-individual debtors like the similarly drafted § 727(a)(1), which explicitly excludes non-individual debtors from discharge under Chapter 7. It provides, "(a) the court shall grant the debtor a discharge, unless— (1) the debtor is not an individual." 11 U.S.C. § 727(a)(1). Because § 1192 does not contain any provision that would preclude non-individual debtors from obtaining a discharge, the Court holds that the plain language of ***342** § 1192 grants a corporate Subchapter V debtor a discharge of debts provided the debtor meets the statutory requirements.[4] Having established that corporate debtors can receive a discharge in Subchapter V, the Court will now analyze whether Avion can properly file this adversary to seek denial of discharge of its debt.

4 This conclusion is further supported by the existence of this adversary. If Avion did not believe that GFS could receive a discharge, there would be no reason for Avion to file a dischargeability action. Although this issue was not briefed, it bares stating as the provisions of Subchapter V continue to be scrutinized throughout the court system. The Court believes clarification regarding the issue is important and fundamental to the analysis here.

II. ***Claims Under § 523(a)***

Avion brings two causes of action against GFS under § 523(a)(2) based on fraudulent behavior and misrepresentations it alleges GFS made when obtaining financing from Avion. The statutory predicates for these claims are § 523(a)(2)(A) and (a)(2)(B), respectively. To the extent the parties argue about the factual sufficiency of the claims pled, the Court concludes that there is sufficient factual content to survive a motion to dismiss. Consequently, the Court will focus its analysis on the legal sufficiency of the claims under § 523.

GFS posits that Avion's claims under § 523 must be dismissed as a matter of law because § 523(a) applies only to individual debtors, not corporate debtors. Avion, on the other hand, argues that § 1192's use of the generic term "debtor" means that for Subchapter V purposes, § 523(a) applies to both individual and corporate debtors. The issue, therefore, is whether corporate Subchapter V debtors may be held liable for § 523 claims. The Court observes that this is a case of first impression in this Circuit. For the reasons stated below, the Court determines that the interplay between §§ 1192(2) and 523(a) compels the conclusion that in the Subchapter V context, only individuals, not corporations, can be subject to § 523(a) dischargeability actions.

a. The Applicability of § 523(a) to Corporate Subchapter V Debtors

As with any statutory interpretation exercise, the starting point for the analysis is the statute itself. Here, the pertinent statutes requiring interpretation are §§ 1192 and 523(a). § 1192 states, "the court shall grant the debtor a discharge of all debts provided in section 1141(d)(1)(A)." The statute goes on to except from discharge those debts that are "of the kind specified in section 523(a) of this title." 11 U.S.C. § 1192(2). On its face, § 1192(2) seeks to incorporate the list of debts that are deemed nondischargeable found in § 523(a), without regard for the character of the debtor. In the Court's judgment, however, the preamble to § 523(a) is critical to the analysis. Importantly, § 523(a) contains limiting language, stating that "[a] discharge under section 727, 1141, 1192, 1228(a), 1228(b), or 1328(b) of this title does not discharge an *individual* debtor from any debt..." (emphasis added). Based on this language, the Court makes three observations concerning the interplay between §§ 1192 and 523.

First, § 1192(2)'s reference to § 523(a) only incorporates the list of nondischargeable debts, without expanding it. In other words, the language of § 1192(2) does not intend to except from discharge any debts that § 523(a) does not already except. Because § 523(a) unequivocally applies only to individuals, the language of § 1192(2) does not empower § 523(a) to cast a wider net than the text of § 523(a) permits. Had Congress included a phrase in § 1192(2) ***343** explicitly stating that the list found in § 523(a) applies to all debtors proceeding in Subchapter V, then the interpretation would be straightforward. Congress's choice not to insert this language is instructive.

Moreover, if Congress intended the list of debts to be applicable to corporate debtors, it knew how, because it did so in § 1141(d). Section 1141(d)(6) states: "the confirmation of a plan does not discharge *a debtor that is a corporation* from any debt (A) of the kind specified in paragraph 2(A)

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

or 2(B) of section 523(a) that is owed to a governmental unit..."(emphasis added).[5] Similarly, § 1141(d)(2) states: "A discharge under this chapter does not discharge a debtor *who is an individual* from any debt excepted from discharge under section 523 of this title." (emphasis added). This language is evidence that Congress knew, when it drafted § 1192(2), how to distinguish dischargeability based on the type of debtor. Congress did not make this distinction in § 1192(2). Thus, in order to determine to which debtors § 1192(2) refers, one must look to the language of § 523(a), which unequivocally applies only to individuals.

5 The Court notes that because § 1141(d)(6) explicitly applies to corporations, GFS could face potential liability under this statute. § 1141(d)(6), however, only excepts debts under § 523(a)(2) to governmental entities. Here, GFS's debt to Avion is not governmental in nature and thus § 1141(d)(6) would not apply to the debt owned by Avion.

Second, the inclusion of § 1192 in § 523(a) would be rendered meaningless under any other interpretation. When Subchapter V was passed, Congress also amended § 523(a) to add the newly enacted § 1192 to the list of discharge provisions incorporated in the scope of § 523(a)'s discharge exceptions. § 523(a) now reads, "[a] discharge under section...*1192*...does not discharge an individual debtor..." (emphasis added). Section 1192's addition is vital to the analysis because it evinces Congress's intent. Section 1192(2) as written makes § 523 discharge exceptions applicable to "debtors" without regard to whether the debtor is an individual or a corporation. Critically though, had Congress intended § 523(a) exceptions to apply to entities as well, it would be unnecessary to add § 1192 to a statute that plainly applies to individual debtors only. The fact that Congress added § 1192 into § 523 demonstrates that Congress intended § 1192(2) to limit the § 523 exceptions in Subchapter V to individuals only.

This conclusion is mandated by the canon of statutory construction against surplusage. When interpreting statutes, courts should "lean in favor of a construction which will render every word operative, rather than one which may make some idle and nugatory." Antonin Scalia & Bryan A. Garner, Reading Law: The Interpretation of Legal Texts 69, 174 (2012) (citing Thomas M. Cooley, *A Treatise on the Constitutional Limitations Which Rest upon the Legislative Power of the States of the American Union* 58 (1868)). Here, interpreting § 523 as excepting from discharge debts of corporate debtors in Subchapter V would be to ignore the import of § 1192 into § 523(a). The Court believes the correct interpretation is one which gives meaning to the amendment to § 523. This position compels the Court to conclude that discharge exceptions found in § 523 apply to an § 1192 discharge, but only as to individual debtors.

Third, corporate debtors proceeding under Chapter 11 historically have been immune to dischargeability actions under § 523(a). It is well-settled law in this circuit that the § 523 exceptions to discharge apply only to individuals, not to ***344** corporations. *See* ***Garrie v. James L. Gray, Inc.,*** 912 F.2d 808, 812 (5th Cir. 1990) ("the 'willful and malicious injury' exception to discharge,

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

like all of the exceptions to discharge found in section 523(a), applies only to individual, not corporate debtors") (citing ***Yamaha Motor Corp., U.S.A. v. Shadco, Inc.,*** 762 F.2d 668, 670 (8th Cir. 1985)). As this Court itself has explained, it is clear from the language of the Chapter 11 discharge statutes "that corporate debtors in Chapter 11 are not subject to a complaint to determine dischargeability of debt under § 523(a)." ***New Venture Partnership v. JRB Consolidated, Inc. (In re JRB Consolidated, Inc.)***, 188 B.R. 373, 374 (Bankr. W.D. Tex. 1995). For Congress to suddenly depart from this well-established principle when it enacted Subchapter V defies reason.[6] It is much more likely, and confirmed by the language used in Subchapter V, that Congress intended to expand, not discontinue, the principle that Chapter 11 corporate debtors are not subject to § 523(a) complaints to determine dischargeability. Because Subchapter V is merely a subchapter to the broader Chapter 11, this is the required result.

6 While the Court generally is hesitant to rely on legislative history, Judge Paul Bonapfel points out that neither the Report of the Judiciary Committee of the House of Representatives nor testimony given to the Committee regarding § 1192 acknowledged any expansion of the existing Chapter 11 corporate discharge exceptions. Hon. Paul W. Bonapfel, Guide to the Small Business Reorganization Act of 2019, (2022), https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf at 204-205. Bonapfel points out that had Congress intended to make a seismic change to existing Chapter 11 law, one would expect the House Judiciary Committee Report to have pointed out this change. *Id.* at 205. The fact that it did not is further evidence that Congress did not intend § 523's discharge exceptions to apply to Subchapter V corporate debtors.

More compelling, the provisions governing Chapter 11 discharge imply that § 523(a) should not apply to corporate debtors. Section 1141(d)(2) states, "[a] discharge under this chapter does not discharge a debtor *who is an individual* from any debt excepted from discharge under section 523 of this title." (emphasis added). Had Congress intended that corporate debtors also be held to the provisions of § 523(a), then clarifying that only individuals under Chapter 11 are liable for § 523 exceptions to dischargeability makes little sense.

In sum, the statutory language along with the broader Chapter 11 statutory scheme mandate this Court's holding that corporate debtors proceeding under Subchapter V cannot be made defendants in § 523 dischargeability actions. Avion's claims under § 523, therefore, must be dismissed for a lack of legal foundation.

b. This Court's Previous Decision Regarding § 523 Discharge Exceptions in Chapter 12

In concluding that Subchapter V corporate debtors cannot be made defendants in § 523 dischargeability actions, the Court is mindful of its previous opinion deciding a similar issue regarding § 523(a)'s relationship with Chapter 12 discharges. Some courts and commentators have cited this Court's decision in ***In re JRB Consolidated, Inc.***, 188 B.R. 373, arguing that the Court's

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

reasoning allowing a § 523(a) dischargeability action against a corporation in Chapter 12 should be extended with regard to Subchapter V because the language of § 1228(a) (controlling discharge in Chapter 12 cases) and § 1192(2) is substantially similar. ***In re Cleary Packaging, LLC,*** 36 F.4th 509, 516 (4th Cir. 2022); 5 Norton Bankr. L. & Prac. § 107:19 (3d ed. 2021); William L. Norton, III and James B. Bailey, ***345** *The Pros and Cons of the Small Business Reorganization Act of 2019*, 36 EMORY BANKR. DEV. J. 383, 386, n. 25 (2020). For the following reasons, the Court believes that its decision in the instant case disallowing dischargeability actions under § 523 as to corporations in Subchapter V can be harmonized with its previous decision in ***In re JRB Consolidated, Inc.***

In ***In re JRB Consolidated, Inc.***, a creditor filed a complaint to determine dischargeability under §§ 523(a)(2) and 523(a)(6) against the debtor, which was a corporation proceeding under Chapter 12. 188 B.R. at 373. The debtor filed a motion to dismiss the complaint on the grounds that § 523(a) did not apply to corporate Chapter 12 debtors, due to § 523(a)'s explicit application to individuals only. ***Id.*** The Court denied the motion to dismiss, holding that, for the purposes of Chapter 12, the exceptions to discharge found in § 523(a) apply to corporate debtors, not just individual debtors. ***Id.*** Judge Kelly arrived at this conclusion by examining the interplay of §§ 1228 and 523(a).

The Court began its analysis by comparing discharges in Chapter 11 to discharges in Chapter 12. ***Id.*** at 374. The Court noted that Chapter 11 provides, "a discharge under this chapter does not discharge a debtor who is an individual from any debt excepted from discharge under section 523 of this title." 11 U.S.C. § 1141(d)(2). In contrast, Chapter 12's incorporation of § 523 is broader, making the § 523(a) exceptions to discharge applicable to "the debtor" without distinction between corporate debtors and individual debtors: "the court shall grant the debtor a discharge of all debts...except any debt— (2) of the kind specified in section 523(a) of this title." 11 U.S.C. § 1228(a)(2). This distinction convinced Judge Kelly that no inconsistency existed between § 1228(a)'s broader application and the limited application of § 523(a) because "individual debtors are still subject to the § 523(a) exceptions" under Chapter 12. ***Id.*** Thus, Judge Kelly held that § 1228(a) "does not incorporate the limiting definition found in the introductory paragraph of § 523(a)." ***Id.***

The Court recognizes the similarities between the language of §§ 1228(a)(2) and 1192(2). Despite the similar language, the Court does not find its decision in this case as inconsistent with the ruling in ***In re JRB Consolidated***. Critical to Judge Kelly's decision was the difference between the operation of Chapter 11 corporate discharges and Chapter 12 corporate discharges. Judge Kelly pointed out that the provisions of Chapter 11 are narrower, only excepting from discharge 1) a liquidating corporate debtor that would otherwise be denied a discharge under § 727(a) (§ 1141(d)(3)); and 2) individual Chapter 11 debtors who have debts of the kind enumerated in § 523(a) (§ 1141(d)(2)). Given the limited exceptions to discharge in Chapter 11, Judge Kelly observed that "it seems clear from that language that corporate debtors in Chapter 11 are not subject to a complaint

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

to determine dischargeability of debt under § 523(a).” ***Id.*** at 374. Because Subchapter V is not its own chapter of bankruptcy, but rather is a subchapter of Chapter 11, Judge Kelly's analysis regarding Chapter 11 discharges remains applicable to the case here.

Furthermore, Judge Kelly recognized the uniqueness of Chapter 12, stating that the broad language of § 1228(a), “would appear to be consistent with the intent of Congress to provide special treatment for certain kinds of debtors otherwise eligible to file for Chapter 12.” ***Id.*** In short, because Chapter 12 is only available to a small and specific subset of debtors, Chapter 12 cases have unique considerations that are not present in a Chapter 11 case. Therefore, the Court is not mandated to ***346** extend the holding that Chapter 12 corporate debtors are subject to § 523 dischargeability actions into Subchapter V notwithstanding the similar language between §§ 1228(a) and 1192(2).

c. Decisions of Other Bankruptcy Courts

To date, four bankruptcy courts have decided this precise issue. All four bankruptcy courts have held that the § 523(a) exceptions to discharge are applicable only to individuals, not corporations in Subchapter V. ***Jennings v. Lapeer Aviation, Inc. (In re LaPeer Aviation, Inc.),*** Adv. No. 22-03002, 2022 WL 1110072 (Bankr. E.D. Mich. Apr. 13, 2022); ***Catt v. Rtech Fabrications, LLC (In re Rtech Fabrications LLC),*** 635 B.R. 559 (Bankr. D. Idaho 2021); ***Cantwell-Cleary Co., Inc., v. Cleary Packaging (In re Cleary Packaging, LLC),*** 630 B.R. 466 (Bankr. D. Md. 2021), *rev'd* 36 F.4th 509 (4th Cir. 2022); ***Gaske v. Satellite Rest., Inc. Crabcake Factory USA (In re Satellite Rest., Inc. Crabcake Factory USA),*** 626 B.R. 871 (Bankr. D. Md. 2021). All four decisions granted motions to dismiss under Rule 12(b)(6) for failure to state a claim upon which relief can be granted. The Court agrees with the rationales of the courts as explained below.

The bankruptcy courts deciding this issue have been unanimous in pointing out that the limiting language of § 523(a) is dispositive of the issue. As the court in ***In re Lapeer Aviation, Inc.*** observed, “the first sentence of § 523(a) clearly limits the denial of discharge to ‘an individual debtor.’ ” 2022 WL 1110072 at *2. The court goes on to cite numerous pre-Subchapter V cases from across the country to support this proposition. *See* ***id.*** (citing ***In re MF Glob Holdings, Ltd.,*** No-11-15059(MG) 2012 WL 734175 at *3 (Bankr. S.D.N.Y. Mar. 6, 2012)); ***Savoy Records Inc. v. Trafalgar Assocs. (In re Trafalgar Assocs.)*** 53 B.R. 693, 696 (Bankr. S.D.N.Y. 1985); ***Williams v. Sears Holding Co.,*** No. 06-PWG-455-M, 2008 WL 11424255 at *5 (N.D. Ala. Mar. 28 2008); ***Garrie,*** 912 F.2d at 812. As such, the ***Lapeer Aviation*** court found it prudent to expand the reasoning that the preamble to § 523(a), and its limitation to individuals, applies in Subchapter V cases. As discussed above, this Court also finds this limitation applicable to Subchapter V.

Next, the bankruptcy courts have all invoked the canon of statutory interpretation which requires that every word in the statute should be given meaning. The bankruptcy courts explain that “the reference to Section 1192 added to Section 523(a) by [Subchapter V] must be given meaning, and the only reasonable meaning is that Congress intended to continue to limit the application of the

© 2023 Thomson Reuters. No claim to original U.S. Government Works.

Section 523(a) exceptions in a Subchapter V case to individuals." ***In re Satellite Rest., Inc.,*** 626 B.R. at 876. The Court finds this reasoning sound and incorporates it herein.

The bankruptcy courts have also analyzed the history of the corporate discharge in Chapter 11. The courts have pointed out that the corporations were subject to discharge exceptions as far back as 1898. ***In re Rtech Fabrications, LLC,*** 635 B.R. at 565 (citing ***In re Cleary Packaging, LLC,*** 630 B.R. at 474). Congress pivoted from that scheme when it introduced the Bankruptcy Code in 1978, by intentionally removing causes of action that enabled creditors to seek a determination of dischargeability against a corporate debtor in Chapter 11. ***In re Cleary Packaging, LLC,*** 630 B.R. at 474. The only exception to discharge for corporations in the current version of the Bankruptcy Code is found in § 1141(d)(6). This exception was controversial enough that it took eight years to be enacted. ***Id.*** Given this ***347** history, according to the ***Cleary Packaging*** bankruptcy court, "the suggestion that Congress incorporated 19 new exceptions to discharge for small corporations in a bill that was introduced in April 2019, and signed into law by the President in August 2019, seems not only improbable, but also contradicts years of bankruptcy law and policy." ***Id.*** at 475. The Court finds this reasoning persuasive.

Finally, the ***Cleary Packaging*** court identified the fact that § 523(a)—and § 1192 more broadly—only comes into play, with respect to a corporate debtor, if the confirmed plan was a nonconsensual one. ***Id.*** It makes little sense for Congress to except from discharge debts of the kind specified in § 523 as to Debtor A whose plan is nonconsensual but not as to Debtor B whose plan is consensual. This struck the court as a result that "is arbitrary and undermines the equality principles of creditor treatment under the Code." ***Id.*** at 476. This Court agrees.

d. The Fourth Circuit's Opinion in *In re Cleary Packaging, LLC*

The Fourth Circuit, in reversing the bankruptcy court, considered the statutes at issue and determined that Congress intended to make § 523(a) exceptions to discharge applicable to all debtors proceeding under Subchapter V. To support this conclusion, the Fourth Circuit makes six primary arguments based on an analysis of the text, an examination of the purpose Subchapter V, as well as a discussion concerning fairness and equity.

At the outset, the Fourth Circuit proclaimed that "[t]he section's use of the word 'debt' is, we believe, decisive, as it does not lend itself to encompass the 'kind' of *debtors* discussed in the language of § 523(a)." ***In re Cleary Packaging, LLC,*** 36 F.4th at 515 (emphasis in original). Further, the court reasoned that "§ 1192(2)'s cross-reference to § 523(a) does not refer to any *kind of debtor* addressed by § 523(a) but rather to a *kind of debt* listed in § 523(a)." ***Id.*** This Court does not necessarily disagree with the idea that the word debt does not require considering the kind of debtor. Indeed, had § 523(a) not been amended to include § 1192 in its limiting language, the Fourth Circuit's interpretation could be correct. Congress did, however, amend § 523(a) to include § 1192 into the limiting language, which in the Court's view, changes the result.

In addressing this point, the Fourth Circuit countered that "to the extent that one might find tension between the language of § 523(a) addressing individual debtors and language of § 1192(2) addressing both individual and corporate debtors—that the more specific provision should govern over the more general." ***Id.*** (citing ***S.W. Ga. Farm Credit, Aca v. Breezy Ridge Farms, Inc. (In re Breezy Ridge Farms, Inc.),*** No. 09-1011, 2009 WL 1514671, at *2 (Bankr. M.D. Ga. May 29, 2009)). Because § 1192(2) applies only to Subchapter V, whereas § 523(a) applies to all chapters of the Bankruptcy Code, the Fourth Circuit concluded that § 1192(2)'s inclusion of all debtors should control. In this Court's judgment, the Fourth Circuit misapplied this principle. The "general/specific" canon only applies "when conflicting provisions simply cannot be reconciled—when the attribution of no permissible meaning can eliminate the conflict." Scalia & Garner, *supra,* at 183. To reiterate, the Court believes its interpretation maintains harmony between §§ 523(a) and 1192(2). This is mostly because of § 1192(2)'s appearance in the text of § 523(a). Thus, this Court disagrees with the Fourth Circuit's application of the canon.

Next, the Fourth Circuit found support for its decision in the scope of discharge found in other chapters of the Bankruptcy ***348** Code. For example, Chapter 13 and Chapter 7 discharges are only available to individuals. Chapter 11 discharges are available to both individuals and corporations, but Congress was explicit in "excluding a different array of debts from discharge" for each type of debtor. ***In re Cleary Packaging, LLC,*** 36 F.4th at 516. The Fourth Circuit concludes that, because "Congress conscientiously defined and distinguished the kinds of debtors covered by each provision" then its decision to have the discharge provision in Subchapter V apply to both individuals and non-individuals is evidence that Congress intended individuals and non-individuals' discharge under Subchapter V to be treated the same. ***Id.***

While plausible, the history of Chapter 11 corporate discharge supports the opposite conclusion. As discussed above, corporations have not been subject to § 523(a) exceptions to discharge since the inception of the Bankruptcy Code, in part to soothe problems with implementing a corporate exception to discharge that arose under the previous scheme. ***In re Rtech Fabrications, LLC,*** 635 B.R. at 565 (citing ***In re Cleary Packaging, LLC,*** 630 B.R. at 474). Given this history, Judge Paul Bonapfel remarks that "it is difficult to conclude that, in enacting a statute universally proclaimed to have the purpose of facilitating reorganization of small businesses, by among other things, eliminating the absolute priority rule in a cramdown situation, Congress in 2019 intended to reintroduce all the problems with exceptions to the discharge of a corporation that it eliminated over 50 years earlier." Bonapfel, *supra,* at 237. This Court finds Judge Bonapfel's reasoning persuasive and adopts it here.

The Fourth Circuit then observed that § 523(a)'s limitation to individuals is difficult to reconcile with § 1141(d)(6)'s reference to § 523(a) and its instructions that it applies only to corporate debtors. ***In re Cleary Packaging, LLC,*** 36 F.4th at 516. The Fourth Circuit points out that § 1141

is also present in § 523(a)'s limiting preamble. ***Id.*** In other words, the Fourth Circuit takes the position that if the phrase "of a kind" in § 1192(2) incorporates 523(a)'s limiting language, then the same phrase in § 1141(d)(6) must also limit § 523(a)'s incorporation in § 1141(d)(6) to individuals. According to the Fourth Circuit, this interpretation would render § 1141(d)(6)'s application to only corporations meaningless. ***Id.***

The context in which §§ 1141(d)(6) and 1192(2) operate resolves this tension, to the extent it exists. Section 1141(d)(6) references specific subparagraphs of § 523(a)(2), and only provides an exception to discharge for debts from certain entities. 11 U.S.C. § 1141(d)(6) (excepting from discharge debts under § 523(a)(2), but only as to debts to governmental entities). Section 1192(2), in contrast, applies § 523(a) more broadly. There are no limitations placed on how § 523(a) would apply to a potential corporate defendant. The Court, therefore, agrees with Judge Bonapfel that the context of the statutes "make[s] it appropriate to interpret the same words differently." Bonapfel, *supra,* at 219.

The Fourth Circuit further supported its position by analogizing Chapter 12's language in § 1228(a) to the language of § 1192(2) by citing two cases which analyze the language in § 1228(a) and hold that the § 523(a) exceptions to discharge it contains are applicable to both corporate and individual debtors. *See* ***In re Cleary Packaging, LLC,*** 36 F.4th at 516 (citing ***In re JRB Consolidated, Inc.,*** 188 B.R. 373; ***In re Breezy Ridge Farms, Inc.,*** 2009 WL 1514671). Because the language of § 1228(a) and § 1192(2) are "virtually identical", then the Fourth Circuit reasons that the two provisions should be interpreted ***349** the same way. ***Id.*** One of the cases the Fourth Circuit relies on is this Court's prior ruling in ***In re JRB Consolidated, Inc.*** 188 B.R. 373. As analyzed above, this Court does not believe that the same result is mandated despite the similar language in Chapter 12, primarily because "§ 1141(d) distinguishes between individual and corporate discharges." Bonapfel, *supra*, at 224. As one of the bankruptcy courts remarked, "[t]he lack of such distinction within Chapter 12 considered in conjunction with the narrowly circumscribed type of entity that may be a Chapter 12 debtor renders analogy between the two discharge provisions unpersuasive." ***In re Cleary Packaging, LLC,*** 630 B.R. at 472, n. 9 (quoting ***United States ex rel. Minge v. Hawker Beechcraft, Inc. (In re Hawker Beechcraft, Inc.),*** 515 B.R. 416, 430 (S.D.N.Y. 2014)). This Court likewise finds any comparison between Subchapter V and Chapter 12 unavailing.

The Fourth Circuit next argued that its interpretation is grounded in the purposes of Subchapter V as contrasted by Chapter 11 procedures more broadly. The Fourth Circuit observed that Chapter 11 explicitly makes distinctions between discharge provisions applicable to individual debtors and discharge provisions applicable to corporate debtors. The discharge provision of Subchapter V, however, "provides benefits to small business debtors, regardless of whether they are individuals or corporations." ***In re Cleary Packaging, LLC,*** 36 F.4th at 517. Therefore, the Circuit concluded, "an important purpose for Subchapter V would be frustrated" if the bankruptcy court's interpretation were given effect. ***Id.***

This Court finds this argument puzzling. Exactly what purpose would be frustrated by keeping with the decades-long policy of exempting entities from discharge exceptions under § 523(a) is unclear. In fact, this Court believes that it is the Fourth Circuit's opinion that would frustrate the entire Chapter 11 statutory scheme. Because making § 523(a) applicable to corporations is such a deviation from the common understanding of the Bankruptcy Code, Subchapter V's inclusion in Chapter 11 becomes less fitting. Had Congress intended that Subchapter V operate differently in this way, it could have created a new chapter of bankruptcy for small businesses. Nonetheless, Congress chose to include Subchapter V into the broader Chapter 11 scheme. This Court views this choice as instructive. Moreover, the practical effect of making § 523(a) applicable to corporations in Subchapter V cases, but not in traditional Chapter 11 cases would disincentivize corporations from availing themselves of the benefits of Subchapter V. The idea that Congress would aim to create a simpler option for a corporation to pursue bankruptcy while simultaneously implementing impediments to that debtor achieving a discharge of its debts defies reason.

Finally, the Fourth Circuit defended its view by invoking fairness and equity principles. The court recognized that, with the elimination of the absolute priority rule, creditors' rights have been altered in Subchapter V. According to the Fourth Circuit, this means that Congress must have intended § 523(a) to apply to all debtors as a way of counteracting this change in treatment. The Fourth Circuit summarized its position this way: "[g]iven the elimination of the absolute priority rule, Congress understandably applied limitations on the discharge of debts to provide an additional layer of fairness and equity to creditors to balance against the altered order of priority that favors the debtor." ***Id.***

This Court observes that in general unsecured creditors in a Subchapter V corporate case are benefitted, not harmed, by ***350** shielding the debtor from having any debts deemed nondischargeable. For example, if a debtor carries a nondischargeable debt, the debtor would be wise to seriously consider converting to a Chapter 7 liquidation. Unsecured creditors generally receive less under a liquidation than under a feasible plan because liquidation "results in competition for available funds between unsecured creditors with dischargeable debts and those with nondischargeable debts." Bonapfel, *supra,* at 234. The bad news for those creditors whose debts are dischargeable is that "every dollar paid on the nondischargeable debt in excess of a pro rata share of disposable income is a dollar that is not paid to unsecured creditors generally." *Id*. In the end, the courts may be met with mounds of dischargeability actions from creditors all seeking to have their debts deemed nondischargeable. This strikes the Court as a loss for everyone involved. Consequently, the Court is unconvinced by the Fourth Circuit's fairness argument.

For the foregoing reasons, the Court disagrees with the Fourth Circuit's decision in ***In re Cleary Packaging, LLC,*** and joins its sister bankruptcy courts in holding that corporate Subchapter V

debtors should not be subject to § 523 dischargeability actions. Accordingly, Avion's claims against GFS under § 523(a)(2) are dismissed with prejudice under Rule 12(b)(6).

III. *Claims Under § 727(a)*

Avion also brings three claims under § 727(a) seeking a determination that GFS be denied a discharge of any debts. Specifically, Avion alleges causes of action under § 727(a)(3), (4), and (5) respectively. GFS, in its Motion to Dismiss, argues that these claims should be dismissed as a matter of law because § 727 applies only to Chapter 7 proceedings. In response, Avion argues that § 1141(d)(3)(C) incorporates § 727 into Chapter 11 proceedings, and thus GFS is subject to its discharge exclusions. Interestingly, the Motion to Dismiss does not contest the plausibility of the § 727 claims as pled, instead focusing solely on the inapplicability of § 727 and seeking dismissal of those claims as a matter of law. Consequently, the Court determines that the § 727 claims are sufficiently pled and will tailor its analysis to the applicability of § 727 to Chapter 11.

Section 727 of the Bankruptcy Code governs discharge in Chapter 7 cases. Specifically, subsection (a) of § 727 governs the exceptions to discharge. Most often, § 727 is invoked when a creditor, in a Chapter 7 proceeding, seeks a determination that the debtor should not be entitled to a discharge of any of its debts. Avion is correct in asserting that § 1141(d)(3)(C) incorporates the conduct that would deny a debtor's discharge under § 727 into Chapter 11 cases. Section 1141(d)(3)(C) states: "(3) the confirmation of a plan does not discharge a debtor if—...(C) the debtor would be denied a discharge under section 727(a) of this title if the case were a case under Chapter 7 of this title." The plain language of this provision imports § 727 liability into Chapter 11 cases. To the Court's way of thinking, § 1141(d)(3)(C) asks a court to treat the Subchapter V case as if it were a Chapter 7 case and measure the debtor's conduct against the list of nondischargeable actions in § 727(a).

What Avion ignores, however, is that § 1181(c) makes § 1141 inapplicable to this particular case because the confirmed plan is nonconsensual. Section 1181(c) states: "[i]f a plan is confirmed under section 1191(b) of this title, section 1141(d) of this title shall not apply, except as provided in section 1192 of this title." Here, the Court confirmed GFS's plan of reorganization under § 1191(b) because it was a nonconsensual ***351** plan. Consequently, § 1181(c) operates to make any subsections of § 1141(d) inapplicable, including § 1141(d)(3)(C), the vehicle used by Avion to import § 727 liability. There is no provision in § 1192 that would reinstate § 1141(d)'s applicability to the case.

Even if § 1141(d) was in play here, § 1141(d)(3)(C) is only one element of the broader provisions of § 1141(d)(3). Notably, the other two elements are not met here. Section 1141(d)(3) as a whole states,

> [t]he confirmation of a plan does not discharge a debtor if (A) the plan provides for the liquidation of all or substantially all of the property of the estate; (B) the debtor does not engage in business after consummation of the plan; and (C) the debtor would be denied a discharge under section 727(a) of this title if the case were a case under Chapter 7 of this title.

11 U.S.C. § 1141(d)(3)(C). The word "and" is critical because it operates to create an all or nothing proposition. Here, GFS's Subchapter V plan does not contemplate liquidating property of the estate, and the business will continue to operate past the confirmation of the plan (as a means to fund the plan). These two circumstances leave § 1141(d)(3)(A) and (B) unsatisfied and thus render (C) inoperative. Because Avion relies on § 1141(d)(3) to import § 727 liability to GFS, all subsections of § 1141(d)(3) must be present for § 727 to apply here. Since at least subsections (A) and (B) are inapplicable, it follows that § 727 is also inapplicable.

Furthermore, even if § 727(a) did apply to this case, it does not apply to entities by virtue of its language. Section 727(a)(1) explicitly excepts non-individual debtors from discharge under Chapter 7. ("The court shall grant the debtor a discharge, unless—the debtor is not an individual"). The other eleven subsections of § 727 describe conduct that would make a debtor ineligible for a discharge. If the other subsections were intended to include non-individual debtors, there would be no need to specifically exclude non-individual debtors at the outset of § 727. The Court again declines to offer an interpretation that renders part of the statute superfluous. Scalia & Garner, *supra,* at 174. Accordingly, the Court determines that § 727's limits on dischargeability do not apply to GFS insofar as GFS is not an individual debtor. Therefore, all causes of action under § 727 shall be dismissed under Rule 12(b)(6) for failure to state a claim upon which relief can be granted.

IV. ***Claim Under § 1141(d)(3)***

Similarly, the Court dismisses Avion's claim under § 1141(d)(3) for failure to state a claim upon which relief can be granted. Although the Court believes that Avion's complaint is factually sufficient to support a claim, it fails as a matter of law for two reasons. First, § 1141(d)(3) does nothing more than incorporate § 727 dischargeability claims into liquidating Chapter 11 cases. As such, there is no independent dischargeability claim under this statute. As just discussed, § 727 does not apply to GFS and thus Avion's reliance on § 1141(d)(3) for a dischargeability claim does not state a claim upon which relief can be granted.

Second, as discussed with regard to the § 727 claims, the provisions of Subchapter V render § 1141(d) inapplicable to this case. Again, because the confirmed plan here is nonconsensual, § 1181(c) becomes operative, thus eliminating § 1141(d) from use in this case. Therefore, Avion's

WESTLAW © 2023 Thomson Reuters. No claim to original U.S. Government Works.

dischargeability claim under § 1141(d)(3) is legally insufficient to proceed and must be dismissed under Rule 12(b)(6).

CONCLUSION

For the foregoing reasons, the Court holds that corporate debtors electing to ***352** proceed under Subchapter V of Chapter 11 are not subject to complaints to determine dischargeability pursuant to § 523(a). Additionally, §§ 727 and 1141(d) are not applicable in this case and do not provide a basis for a dischargeability action against GFS here.

Accordingly, IT IS ORDERED that Defendant's First Amended Rule 12(b)(6) Motion to Dismiss Plaintiff's Complaint (ECF No. 6) is GRANTED.

IT IS FURTHER ORDERED that Plaintiff's Original Complaint for Determination of Dischargeability of Debt Pursuant to 11 U.S.C. § 523(a)(2) & (4) (ECF No. 1) is DISMISSED WITH PREJUDICE to refiling.

All Citations

647 B.R. 337

End of Document © 2023 Thomson Reuters. No claim to original U.S. Government Works.

Debts for a Partner's Fraud Are Still Nondischargeable

Bartenwerfer v. Buckley, No. 21-908, 598 U.S. ___ (2023)

--- S.Ct. ----
Only the Westlaw citation is currently available.
Supreme Court of the United States.

Kate Marie BARTENWERFER, Petitioner
v.
Kieran BUCKLEY

No. 21-908
|
Argued December 6, 2022
|
Decided February 22, 2023

Synopsis
Background: Judgment creditor filed adversary complaint, seeking determination that debt was excepted from discharge because Chapter 7 debtors fraudulently concealed material defects plaguing renovated house that they sold to him prepetition. Following bench trial, the United States Bankruptcy Court for the Northern District of California, Hannah L. Blumenstiel, J., 549 B.R. 222, ruled that debt was nondischargeable, and appeals were taken. The Bankruptcy Appellate Panel, 2017 WL 6553392, affirmed judgment as to debtor-husband, but vacated and remanded as to debtor-wife. On remand, after a second bench trial, the Bankruptcy Court, Blumenstiel, J., 596 B.R. 675, entered judgment in favor of debtor-wife. Judgment creditor appealed. The Bankruptcy Appellate Panel, 2020 WL 1970506, affirmed. Cross-appeals were taken. The United States Court of Appeals for the Ninth Circuit, 860 Fed.Appx. 544, reversed in relevant part and remanded with instructions. Certiorari was granted.

In a unanimous opinion, the Supreme Court, Justice Barrett, held that the subject debt, which arose from sale proceeds obtained by debtor-husband's fraudulent misrepresentations in selling to judgment creditor a house that debtors had remodeled as business partners, was a debt for money obtained by false pretenses, a false representation, or actual fraud within the meaning of the discharge exception, and so debtor-wife was precluded from discharging her liability for it, regardless of her own culpability, abrogating *Sullivan v. Glenn*, 782 F.3d 378, and *Matter of Walker*, 726 F.2d 452.

Affirmed.

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

Justice Sotomayor filed a concurring opinion in which Justice Jackson joined.

Procedural Posture(s): Petition for Write of Certiorari; On Appeal; Judgment.

Syllabus [*]

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

***1** Kate and David Bartenwerfer decided to remodel the house they jointly owned in San Francisco and to sell it for a profit. David took charge of the project, while Kate remained largely uninvolved. They eventually sold the house to respondent Kieran Buckley. In conjunction with the sale, Kate and David attested that they had disclosed all material facts related to the property. After the purchase, Buckley discovered several defects that the Bartenwerfers had failed to disclose. Buckley sued in California state court and won, leaving the Bartenwerfers jointly responsible for more than $200,000 in damages. Unable to pay that judgment or their other creditors, the Bartenwerfers filed for Chapter 7 bankruptcy. Buckley then filed an adversary complaint in the bankruptcy proceeding, alleging that the debt owed him on the state-court judgment was nondischargeable under the Bankruptcy Code's exception to discharge of “any debt ... for money ... to the extent obtained by ... false pretenses, a false representation, or actual fraud.” 11 U.S.C. § 523(a)(2)(A). The Bankruptcy Court found that David had committed fraud and imputed his fraudulent intent to Kate because the two had formed a legal partnership to renovate and sell the property. The Bankruptcy Appellate Panel disagreed as to Kate's culpability, holding that § 523(a)(2)(A) barred her from discharging the debt only if she knew or had reason to know of David's fraud. On remand, the Bankruptcy Court determined that Kate lacked such knowledge and could therefore discharge her debt to Buckley. The Bankruptcy Appellate Panel affirmed. The Ninth Circuit reversed in relevant part. Invoking *Strang v. Bradner*, 114 U.S. 555, 5 S.Ct. 1038, 29 L.Ed. 248, the court held that a debtor who is liable for her partner's fraud cannot discharge that debt in bankruptcy, regardless of her own culpability.

Held: Section 523(a)(2)(A) precludes Kate Bartenwerfer from discharging in bankruptcy a debt obtained by fraud, regardless of her own culpability. Pp. —— – ——.

(a) Kate (hereinafter, Bartenwerfer) disputes a straightforward reading of § 523(a)(2)(A)’s text. Bartenwerfer argues that an ordinary English speaker would understand that “money obtained by fraud” means money obtained by the *individual debtor’s* fraud. This Court disagrees. The passive voice in § 523(a)(2)(A) does not hide the relevant actor in plain sight, as Bartenwerfer suggests —it removes the actor altogether. Congress framed § 523(a)(2)(A) to “focu[s] on an event that occurs without respect to a specific actor, and therefore without respect to any actor's intent or

culpability." *Dean v. United States*, 556 U.S. 568, 572, 129 S.Ct. 1849, 173 L.Ed.2d 785. It is true that context can confine a passive-voice sentence to a likely set of actors. See, *e.g., E. I. du Pont de Nemours & Co. v. Train*, 430 U.S. 112, 128–129, 97 S.Ct. 965, 51 L.Ed.2d 204. But the legal context relevant to § 523(a)(2)(A)—the common law of fraud—has long maintained that fraud liability is *not* limited to the wrongdoer. Understanding § 523(a)(2)(A) to reflect "agnosticism" as to the identity of the wrongdoer is consistent with the age-old rule of fraud liability.

***2** Bartenwerfer points out that " 'exceptions to discharge should be confined to those plainly expressed.' " *Bullock v. BankChampaign, N. A.*, 569 U.S. 267, 275, 133 S.Ct. 1754, 185 L.Ed.2d 922. The Court, however, has never used this principle to artificially narrow ordinary meaning, invoking it instead to stress that exceptions should not extend beyond their stated terms. See, *e.g., Gleason v. Thaw*, 236 U.S. 558, 559–562, 35 S.Ct. 287, 59 L.Ed. 717.

Bartenwerfer also seeks support from § 523(a)(2)(A)'s neighboring provisions in subparagraphs (B) and (C), both of which require some culpable action by the debtor herself. Bartenwerfer claims that these neighboring provisions make explicit what is unstated in (A). This argument turns on its head the rule that " '[w]hen Congress includes particular language in one section ... but omits it in another section of the same Act,' " the Court generally takes "the choice to be deliberate." *Badgerow* v. *Walters*, 596 U. S. ––––, ––––, 142 S.Ct. 1310, 212 L.Ed.2d 355. If there is an inference to be drawn here, the more likely one is that (A) excludes debtor culpability from consideration given that (B) and (C) expressly hinge on it. Bartenwerfer suggests it would defy credulity to think that Congress would bar debtors from discharging liability for fraud they did not personally commit under (A) while allowing debtors to discharge debt for (potentially more serious) fraudulent statements they did not personally make under (B). But the Court offered a possible answer for this disparity in *Field v. Mans*, 516 U.S. 59, 76–77, 116 S.Ct. 437, 133 L.Ed.2d 351. Whatever the rationale, it does not defy credulity to think that Congress established differing rules for (A) and (B). Pp. –––– – ––––.

(b) Any remaining doubt about the textual analysis is eliminated by this Court's precedent and Congress's response to it. In *Strang v. Bradner*, 114 U.S. 555, 5 S.Ct. 1038, 29 L.Ed. 248, the Court held that the fraud of one partner should be imputed to the other partners, who "received and appropriated the fruits of the fraudulent conduct." *Id.,* at 561, 5 S.Ct. 1038. The Court so held despite the fact that the relevant 19th-century discharge exception for fraud disallowed the discharge of debts "created by the fraud or embezzlement *of the bankrupt*." 14 Stat. 533 (emphasis added). And when Congress next overhauled bankruptcy law, it deleted the phrase "of the bankrupt" from the discharge exception for fraud. The unmistakable implication is that Congress embraced *Strang*'s holding. See *Ysleta Del Sur Pueblo* v. *Texas*, 596 U. S. ––––, ––––, 142 S.Ct. 1929, 213 L.Ed.2d 221. Pp. –––– – ––––.

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

(c) Finally, Bartenwerfer insists that the preclusion of faultless debtors from discharging liabilities run up by their associates is inconsistent with bankruptcy law's "fresh start" policy. But the Bankruptcy Code is not focused on the unadulterated pursuit of the debtor's interest, and instead seeks to balance multiple, often competing interests. Bartenwerfer's fairness-based critiques also miss the fact that § 523(a)(2)(A) does not define the scope of one's liability for another's fraud. Section 523(a)(2)(A) takes the debt as it finds it, so if California did not extend liability to honest partners, § 523(a)(2)(A) would have no role here. And while Bartenwerfer paints a picture of liability being imposed on hapless bystanders, fraud liability generally requires a special relationship to the wrongdoer and, even then, defenses to liability are available. Pp. ——– ——.

***3** 860 Fed.Appx. 544, affirmed.

BARRETT, J., filed an opinion for a unanimous Court. SOTOMAYOR, J., filed a concurring opinion, in which JACKSON, J., joined.

Attorneys and Law Firms

Sarah M. Harris, Washington, DC, for Petitioner.

Zachary D. Tripp, Washington, DC, for Respondent.

Erica L. Ross for United States as amicus curiae, by special leave of the Court, supporting respondent.

Iain Angus MacDonald, MacDonald Fernandez LLP, San Francisco, CA, Reno Fernandez, Anna-Rose Mathieson, Complex Appellate Litigation Group LLP, San Francisco, CA, Lisa S. Blatt, Counsel of Record, Sarah M. Harris, Andrew L. Hoffman, Aaron Z. Roper, Mary E. Goetz, Williams & Connolly LLP, Washington, DC, for Petitioner.

Janet Marie Brayer, Law Offices of Janet Brayer, Moss Beach, CA, Zachary D. Tripp, Counsel of Record, Weil, Gotshal & Manges LLP, Washington, DC, Robert B. Niles-Weed, Rachel M. Kaplowitz, Sara B. Weiss, Weil, Gotshal & Manges LLP, New York, NY, for Respondent.

Opinion

Justice BARRETT delivered the opinion of the Court.

The Bankruptcy Code strikes a balance between the interests of insolvent debtors and their creditors. It generally allows debtors to discharge all prebankruptcy liabilities, but it makes exceptions when, in Congress's judgment, the creditor's interest in recovering a particular debt outweighs the debtor's interest in a fresh start. One such exception bars debtors from discharging

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

any debt for money "obtained by ... fraud." 11 U.S.C. § 523(a)(2)(A). The provision obviously applies to a debtor who was the fraudster. But sometimes a debtor is liable for fraud that she did not personally commit—for example, deceit practiced by a partner or an agent. We must decide whether the bar extends to this situation too. It does. Written in the passive voice, § 523(a)(2)(A) turns on how the money was obtained, not who committed fraud to obtain it.

I

In 2005, Kate Bartenwerfer and her then-boyfriend, David Bartenwerfer, jointly purchased a house in San Francisco. Acting as business partners, the pair decided to remodel the house and sell it at a profit. David took charge of the project. He hired an architect, structural engineer, designer, and general contractor; he monitored their work, reviewed invoices, and signed checks. Kate, on the other hand, was largely uninvolved.

Like many home renovations, the Bartenwerfers' project was bumpier than anticipated. Still, they managed to get the house on the market, and Kieran Buckley bought it. In conjunction with the sale, the Bartenwerfers attested that they had disclosed all material facts relating to the property. Yet after the house was his, Buckley discovered several defects that the Bartenwerfers had not divulged: a leaky roof, defective windows, a missing fire escape, and permit problems. Alleging that he had overpaid in reliance on the Bartenwerfers' misrepresentations, Buckley sued them in California state court. The jury found in Buckley's favor on his claims for breach of contract, negligence, and nondisclosure of material facts, leaving the Bartenwerfers jointly responsible for more than $200,000 in damages.

The Bartenwerfers were unable to pay Buckley, not to mention their other creditors. Seeking relief, they filed for Chapter 7 bankruptcy, which allows debtors to get a "fresh start" by discharging their debts. *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007) (internal quotation marks omitted). While that sounds like complete relief, there is a catch—not all debts are dischargeable. The Code makes several exceptions to the general rule, including the one at issue in this case: Section 523(a)(2)(A) bars the discharge of "any debt ... for money ... to the extent obtained by ... false pretenses, a false representation, or actual fraud."

Buckley filed an adversary complaint alleging that the money owed on the state-court judgment fell within this exception. After a 2-day bench trial, the Bankruptcy Court decided that neither David nor Kate Bartenwerfer could discharge their debt to Buckley. Based on testimony from the parties, real-estate agents, and contractors, the court found that David had knowingly concealed the house's defects from Buckley. And the court imputed David's fraudulent intent to Kate because the two had formed a legal partnership to execute the renovation and resale project.

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

***4** The Ninth Circuit's Bankruptcy Appellate Panel agreed as to David's fraudulent intent but disagreed as to Kate's. As the panel saw it, § 523(a)(2)(A) barred her from discharging the debt only if she knew or had reason to know of David's fraud. It instructed the Bankruptcy Court to apply that standard on remand, and, after a second bench trial, the court concluded that Kate lacked the requisite knowledge of David's fraud and could therefore discharge her liability to Buckley. This time, the Bankruptcy Appellate Panel affirmed the judgment.

The Ninth Circuit reversed in relevant part. *In re Bartenwerfer*, 860 Fed.Appx. 544 (2021). Invoking our decision in *Strang v. Bradner*, 114 U.S. 555, 5 S.Ct. 1038, 29 L.Ed. 248 (1885), it held that a debtor who is liable for her partner's fraud cannot discharge that debt in bankruptcy, regardless of her own culpability. 860 Fed.Appx. at 546. Kate thus remained on the hook for her debt to Buckley. *Id.*, at 546–547. We granted certiorari to resolve confusion in the lower courts on the meaning of § 523(a)(2)(A).[1] 596 U. S. ——, —— S.Ct. ——, —— L.Ed.2d —— (2022).

1 See, *e.g.*, *In re M.M. Winkler & Assoc.*, 239 F.3d 746, 749 (CA5 2001) (debts that arise from fraud cannot be discharged); *In re Ledford*, 970 F.2d 1556, 1561 (CA6 1992) (no discharge if the debtor benefited from the fraud); *Sullivan v. Glenn*, 782 F.3d 378, 381 (CA7 2015) (a debt is nondischargeable only if the debtor knew or should have known of the fraud); *In re Walker*, 726 F.2d 452, 454 (CA8 1984) (same); *In re Villa*, 261 F.3d 1148, 1151 (CA11 2001) (a debt cannot be discharged when fraud is imputed to the debtor under agency principles).

II

A

"[W]e start where we always do: with the text of the statute." *Van Buren* v. *United States*, 593 U. S. ——, ——, 141 S.Ct. 1648, 1654, 210 L.Ed.2d 26 (2021). Section 523(a)(2)(A) states:

> "A discharge under section 727 ... of this title does not discharge an individual debtor from any debt ...
>
> "(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
>> "(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition."

By its terms, this text precludes Kate Bartenwerfer from discharging her liability for the state-court judgment. (From now on, we will refer to Kate as "Bartenwerfer.") First, she is an "individual debtor." Second, the judgment is a "debt." And third, because the debt arises from the sale proceeds obtained by David's fraudulent misrepresentations, it is a debt "for money ... obtained by ... false pretenses, a false representation, or actual fraud."

Bartenwerfer disputes the third premise. She admits that, as a grammatical matter, the passive-voice statute does not specify a fraudulent actor. But in her view, the statute is most naturally read to bar the discharge of debts for money obtained by *the debtor's* fraud.[2] To illustrate, she offers the sentence "Jane's clerkship was obtained through hard work." According to Bartenwerfer, an ordinary English speaker would understand this sentence to mean that *Jane's* hard work led to her clerkship. Brief for Petitioner 20. Section 523(a)(2)(A) supposedly operates the same way: An ordinary English speaker would understand that "money obtained by fraud" means money obtained by the *individual debtor's* fraud. Passive voice hides the relevant actor in plain sight.

2 Buckley contends that Bartenwerfer has forfeited this argument because in her petition for a writ of certiorari and in the lower courts, she asserted that § 523(a)(2)(A) bars discharge when the debtor "knew or should have known" of her partner's fraud. We disagree. The question presented is whether a debtor can be "subject to liability for the fraud of another that is barred from discharge in bankruptcy ... without any act, omission, intent or knowledge of her own." Pet. for Cert. i. Bartenwerfer's current argument—that the debt must arise from the debtor's own fraud—is "fairly included" within that question and her position in the lower courts. Supreme Court Rule 14.1(a); *Yee v. Escondido*, 503 U.S. 519, 534, 112 S.Ct. 1522, 118 L.Ed.2d 153 (1992).

***5** We disagree: Passive voice pulls the actor off the stage. At least on its face, Bartenwerfer's sentence conveys only that *someone's* hard work led to Jane's clerkship—whether that be Jane herself, the professor who wrote a last-minute letter of recommendation, or the counselor who collated the application materials. Section 523(a)(2)(A) is similarly broad. Congress framed it to "focu[s] on an event that occurs without respect to a specific actor, and therefore without respect to any actor's intent or culpability." *Dean v. United States*, 556 U.S. 568, 572, 129 S.Ct. 1849, 173 L.Ed.2d 785 (2009); B. Garner, Modern English Usage 676 (4th ed. 2016) (the passive voice signifies that "the actor is unimportant" or "unknown"). The debt must result from someone's fraud, but Congress was "agnosti[c]" about who committed it. *Watson v. United States*, 552 U.S. 74, 81, 128 S.Ct. 579, 169 L.Ed.2d 472 (2007).

It is true, of course, that context can confine a passive-voice sentence to a likely set of actors. *E. I. du Pont de Nemours & Co. v. Train*, 430 U.S. 112, 128–129, 97 S.Ct. 965, 51 L.Ed.2d 204 (1977). If the dean of the law school delivers Bartenwerfer's hypothetical statement to Jane's parents, the most natural implication is that Jane's hard work led to the clerkship. But in the fraud-discharge

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

exception, context does not single out the wrongdoer as the relevant actor. Quite the opposite: The relevant legal context—the common law of fraud—has long maintained that fraud liability is *not* limited to the wrongdoer. *Field v. Mans*, 516 U.S. 59, 70–75, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995) (interpreting § 523(a)(2)(A) with reference to the common law of fraud). For instance, courts have traditionally held principals liable for the frauds of their agents. *McCord v. Western Union Telegraph Co.*, 39 Minn. 181, 185, 39 N.W. 315, 317 (1888); *Tome v. Parkersburg Branch R. Co.*, 39 Md. 36, 70–71 (1873); *White v. Sawyer*, 82 Mass. 586, 589 (1860); J. Story, Commentaries on the Law of Agency 465–467 (1839). They have also held individuals liable for the frauds committed by their partners within the scope of the partnership. *Tucker v. Cole*, 54 Wis. 539, 540–541, 11 N.W. 703, 703–704 (1882); *Alexander v. State*, 56 Ga. 478, 491–493 (1876); *Chester v. Dickerson*, 54 N.Y. 1, 11 (1873); J. Story, Commentaries on the Law of Partnership 161, 257–259 (1841). Understanding § 523(a)(2)(A) to reflect the passive voice's usual "agnosticism" is thus consistent with the age-old rule that individual debtors can be liable for fraudulent schemes they did not devise.

Searching for a way to defeat the natural breadth of the passive voice, Bartenwerfer points to our observation that " 'exceptions to discharge "should be confined to those plainly expressed." ' " *Bullock v. BankChampaign, N. A.*, 569 U.S. 267, 275, 133 S.Ct. 1754, 185 L.Ed.2d 922 (2013) (quoting *Kawaauhau v. Geiger*, 523 U.S. 57, 62, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998)). This does not get her far. We have never used this principle to artificially narrow ordinary meaning, which is what Bartenwerfer asks us to do. Instead, we have invoked it to stress that exceptions should not extend beyond their stated terms. In *Gleason* v. *Thaw*, we held that "liabilities for obtaining property" did not include an attorney's services because services are not property. 236 U.S. 558, 559–562, 35 S.Ct. 287, 59 L.Ed. 717 (1915). In *Kawaauhau*, we concluded that medical malpractice attributable to negligence or recklessness did not amount to a "willful and malicious injury." 523 U.S. at 59, 118 S.Ct. 974. And in *Bullock*, interpreting the discharge exception "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny," we applied the familiar *noscitur a sociis* canon to hold that the term "defalcation" possessed a *mens rea* requirement akin to those of "fraud," "embezzlement," and "larceny." 569 U.S. at 269, 274–275, 133 S.Ct. 1754. In each case, we reached a result that was "plainly expressed" by the text and ordinary tools of interpretation. Our interpretation in this case, which rests on basic tenets of grammar, is more of the same.

***6** Bartenwerfer also seeks support from § 523(a)(2)(A)'s neighboring provisions, which both require action by the debtor herself. Section 523(a)(2)(B) bars the discharge of debts arising from the "use of a statement in writing—(i) that is materially false; (ii) respecting the debtor's or an insider's financial condition; (iii) on which the creditor to whom the debtor is liable ... reasonably relied; and (iv) that *the debtor caused to be made or published with intent to deceive*." (Emphasis added.) Similarly, § 523(a)(2)(C) presumptively bars the discharge of recently acquired "consumer debts owed to a single creditor and aggregating more than $500 for luxury goods or services

incurred by an individual debtor" and "cash advances aggregating more than $750 ... *obtained by an individual debtor*." § 523(a)(2)(C)(i) (emphasis added). Unlike subparagraph (A), the discharge exceptions in subparagraphs (B) and (C) expressly require some culpable act on the part of the debtor. According to Bartenwerfer, these provisions make explicit what goes without saying in (A): The debtor's own fraud must have given rise to the debt.

This argument flips the rule that " '[w]hen Congress includes particular language in one section of a statute but omits it in another section of the same Act,' we generally take the choice to be deliberate." *Badgerow* v. *Walters*, 596 U. S. ––––, ––––, 142 S.Ct. 1310, 1318, 212 L.Ed.2d 355 (2022) (quoting *Collins* v. *Yellen*, 594 U. S. ––––, ––––, 141 S.Ct. 1761, 1782, 210 L.Ed.2d 432 (2021)). As the word "generally" indicates, this rule is not absolute. Context counts, and it is sometimes difficult to read much into the absence of a word that is present elsewhere in a statute. See, *e.g.*, *Field*, 516 U.S. at 67–69, 116 S.Ct. 437. But if there is an inference to be drawn here, it is not the one that Bartenwerfer suggests. The more likely inference is that (A) excludes debtor culpability from consideration given that (B) and (C) expressly hinge on it.

Bartenwerfer retorts that it would have made no sense for Congress to set up such a dichotomy, particularly between (A) and (B). These two provisions are linked: (A) carves out fraudulent "statement[s] respecting the debtor's or an insider's financial condition," while (B) governs such statements that are reduced to writing. In Bartenwerfer's view, it "defies credulity" to think that Congress would bar debtors from discharging liability for mine-run fraud they did not personally commit while simultaneously allowing debtors to discharge liability for (potentially more serious) fraudulent statements they did not personally make. Brief for Petitioner 23.

But in *Field*, we offered a possible answer for why (B) contains a more debtor-friendly discharge rule than (A): Congress may have "wanted to moderate the burden on individuals who submitted false financial statements, not because lies about financial condition are less blameworthy than others, but because the relative equities might be affected by practices of consumer finance companies, which sometimes have encouraged such falsity by their borrowers for the very purpose of insulating their own claims from discharge." 516 U.S. at 76–77, 116 S.Ct. 437. This concern may also have informed Congress's decision to limit (B)'s prohibition on discharge to fraudulent conduct by the debtor herself. Whatever the rationale, it does not "def[y] credulity" to think that Congress established differing rules for (A) and (B). Brief for Petitioner 23.

B

Our precedent, along with Congress's response to it, eliminates any possible doubt about our textual analysis. In the late 19th century, the discharge exception for fraud read as follows: "[N]o debt created by the fraud or embezzlement *of the bankrupt* ... shall be discharged under this act." Act

of Mar. 2, 1867, § 33, 14 Stat. 533 (emphasis added). This language seemed to limit the exception to fraud committed by the debtor herself—the position that Bartenwerfer advocates here.

But we held otherwise in *Strang* v. *Bradner*. In that case, the business partner of John and Joseph Holland lied to fellow merchants in order to secure promissory notes for the benefit of their partnership. 114 U.S. at 557–558, 5 S.Ct. 1038. After a state court held all three partners liable for fraud, the Hollands tried to discharge their debts in bankruptcy on the ground that their partner's misrepresentations "were not made by their direction nor with their knowledge." *Id.*, at 557, 561, 5 S.Ct. 1038. Even though the statute required the debt to be created by the fraud "of the bankrupt," we held that the Hollands could not discharge their debts to the deceived merchants. *Id.*, at 561, 5 S.Ct. 1038. The fraud of one partner, we explained, is the fraud of all because "[e]ach partner was the agent and representative of the firm with reference to all business within the scope of the partnership." *Ibid*. And the reason for this rule was particularly easy to see because "the partners, who were not themselves guilty of wrong, received and appropriated the fruits of the fraudulent conduct of their associate in business." *Ibid*.

***7** The next development—Congress's post-*Strang* legislation—is the linchpin.[3] "This Court generally assumes that, when Congress enacts statutes, it is aware of this Court's relevant precedents." *Ysleta Del Sur Pueblo* v. *Texas*, 596 U. S. ––––, ––––, 142 S.Ct. 1929, 1940, 213 L.Ed.2d 221 (2022). Section 523(a)(2) is no exception to this interpretive rule. *Lamar, Archer & Cofrin, LLP* v. *Appling*, 584 U. S. ––––, –––– – ––––, 138 S.Ct. 1752, 1761–1762, 201 L.Ed.2d 102 (2018). So if Congress had reenacted the discharge exception for fraud without change, we would assume that it meant to incorporate *Strang*'s interpretation. *Appling*, 584 U. S., at –––– – ––––, 138 S.Ct., at 1761–1762; *Lorillard v. Pons*, 434 U.S. 575, 580, 98 S.Ct. 866, 55 L.Ed.2d 40 (1978).

3 Bartenwerfer asserts that we should ignore *Strang* because, as a product of the *Swift* v. *Tyson* era, it turned on the Court's understanding of the general common-law rule rather than its interpretation of the statutory text. 16 Pet. 1, 41 U.S. 1, 10 L.Ed. 865 (1842). This argument is a detour we need not take. Whatever *Strang*'s rationale, it constituted an important part of the background against which Congress drafted the current discharge exception for fraud.

But Congress went even further than mere reenactment. Thirteen years after *Strang*, when Congress next overhauled bankruptcy law, it deleted "of the bankrupt" from the discharge exception for fraud, which is the predecessor to the modern § 523(a)(2)(A). Act of July 1, 1898, § 17, 30 Stat. 550 ("A discharge in bankruptcy shall release a bankrupt from all of his provable debts, except such as ... are judgments in actions for frauds, or obtaining property by false pretenses or false representations, or for willful and malicious injuries to the person or property of another"). By doing so, Congress cut from the statute the strongest textual hook counseling against the outcome in *Strang*. The unmistakable implication is that Congress embraced *Strang*'s holding—so we do too.

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

C

In a last-ditch effort to persuade us, Bartenwerfer invokes the "fresh start" policy of modern bankruptcy law. Precluding faultless debtors from discharging liabilities run up by their associates, she says, is inconsistent with that policy, so § 523(a)(2)(A) cannot apply to her. A contrary holding would be a throwback to the harsh days when "debtors faced 'perpetual bondage to their creditors,' surviving on 'a miserable pittance [and] dependent upon the bounty or forbearance of [their] creditors.' " Brief for Petitioner 16 (quoting 3 J. Story, Commentaries on the Constitution of the United States 5 (1833)). The same Congress that "champion[ed]" the fresh start could not also have shackled honest debtors with liability for frauds that they did not personally commit. Brief for Petitioner 37.

This argument earns credit for color but not much else. To begin, it characterizes the Bankruptcy Code as focused on the unadulterated pursuit of the debtor's interest. But the Code, like all statutes, balances multiple, often competing interests. Section 523 is a case in point: Barring certain debts from discharge necessarily reflects aims distinct from wiping the bankrupt's slate clean. Perhaps Congress concluded that these debts involved particularly deserving creditors, particularly undeserving debtors, or both. Regardless, if a fresh start were all that mattered, § 523 would not exist. No statute pursues a single policy at all costs, and we are not free to rewrite this statute (or any other) as if it did. *Azar* v. *Allina Health Services*, 587 U. S. ––––, ––––, 139 S.Ct. 1804, 1815, 204 L.Ed.2d 139 (2019).

***8** It also bears emphasis—because the thread is easily lost in Bartenwerfer's argument—that § 523(a)(2)(A) does not define the scope of one person's liability for another's fraud. That is the function of the underlying law—here, the law of California. Section 523(a)(2)(A) takes the debt as it finds it, so if California did not extend liability to honest partners, § 523(a)(2)(A) would have no role to play. Bartenwerfer's fairness-based critiques seem better directed toward the state law that imposed the obligation on her in the first place.

And while Bartenwerfer paints a picture of liability imposed willy-nilly on hapless bystanders, the law of fraud does not work that way. Ordinarily, a faultless individual is responsible for another's debt only when the two have a special relationship, and even then, defenses to liability are available. For instance, though an employer is generally accountable for the wrongdoing of an employee, he usually can escape liability if he proves that the employee's action was committed outside the scope of employment. Restatement (Third) of Agency § 7.07 (2006); D. Dobbs, P. Hayden, & E. Bublick, Law of Torts § 425 (2022). Similarly, if one partner takes a wrongful act without authority or outside the ordinary course of business, then the partnership—and by extension, the innocent partners—are generally not on the hook. Uniform Partnership Act § 305

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

(2013). Partnerships and other businesses can also organize as limitedliability entities, which insulate individuals from personal exposure to the business's debts. See, *e.g.*, § 306(c) (limited-liability partnerships); Uniform Limited Partnership Act § 303(a) (2013) (limited partnerships); Uniform Limited Liability Company Act § 304(a) (2013) (limited-liability companies).

Individuals who themselves are victims of fraud are also likely to have defenses to liability. If a surety or guarantor is duped into assuming secondary liability, then his obligation is typically voidable. Law of Suretyship and Guaranty § 6:8 (2022); Restatement (Third) of Suretyship & Guaranty § 12 (1996). Likewise, if a purchaser unwittingly contracts for fraudulently obtained property, he may be able to rescind the agreement. 27 R. Lord, Williston on Contracts § 69:47 (4th ed. 2022). Thus, victims have a variety of antecedent defenses at their disposal that, if successful, protect them from acquiring any debt to discharge in a later bankruptcy proceeding.

All of this said, innocent people are sometimes held liable for fraud they did not personally commit, and, if they declare bankruptcy, § 523(a)(2)(A) bars discharge of that debt. So it is for Bartenwerfer, and we are sensitive to the hardship she faces. But Congress has "evidently concluded that the creditors' interest in recovering full payment of debts" obtained by fraud "outweigh[s] the debtors' interest in a complete fresh start," *Grogan v. Garner*, 498 U.S. 279, 287, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991), and it is not our role to second-guess that judgment.

III

We affirm the Ninth Circuit's judgment that Kate Bartenwerfer's debt is not dischargeable in bankruptcy.

It is so ordered.

Justice SOTOMAYOR, with whom Justice JACKSON joins, concurring.

The Court correctly holds that 11 U.S.C. § 523(a)(2)(A) bars debtors from discharging a debt obtained by fraud of the debtor's agent or partner. Congress incorporated into the statute the common-law principles of fraud, *Husky Int'l Electronics, Inc. v. Ritz*, 578 U.S. 356, 360, 136 S.Ct. 1581, 194 L.Ed.2d 655 (2016) (citing *Field v. Mans*, 516 U.S. 59, 69, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995)), which include agency and partnership principles, *ante*, at –––– – ––––. This Court long ago confirmed that reading when it held that fraudulent debts obtained by partners are not dischargeable, *Strang v. Bradner*, 114 U.S. 555, 559–561, 5 S.Ct. 1038, 29 L.Ed. 248 (1885), and Congress "embraced" that reading when it amended the statute in 1898, *ante,* at ––––.

 © 2023 Thomson Reuters. No claim to original U.S. Government Works.

***9** The Bankruptcy Court found that petitioner and her husband had an agency relationship and obtained the debt at issue after they formed a partnership. Because petitioner does not dispute that she and her husband acted as partners, the debt is not dischargeable under the statute.

The Court here does not confront a situation involving fraud by a person bearing no agency or partnership relationship to the debtor. Instead, "[t]he relevant legal context" concerns fraud only by "agents" and "partners within the scope of the partnership." *Ante,* at –––– – ––––. With that understanding, I join the Court's opinion.

All Citations

598 U.S. ----, --- S.Ct. ----, 2023 WL 2144417

End of Document © 2023 Thomson Reuters. No claim to original U.S. Government Works.