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SCOTUS Bankruptcy Decision Roundup

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On average, the Supreme Court hears a single bankruptcy case each term. But during the October 2022 term, the Supreme Court issued a remarkable four decisions in bankruptcy cases. These decisions, which are summarized below, address appellate issues relating to sale orders, the discharge of claims obtained by fraud, and sovereign immunity issues in two different contexts.

I. Section 363(m) of the Bankruptcy Code is not a jurisdictional provision that precludes appellate review of asset sale orders.

In MOAC Mall Holdings LLC v. Transform Holdco LLC, 598 U.S. ---, 143 S. Ct. 927 (2023), the Supreme Court resolved a circuit split by determining that section 363(m) of the Bankruptcy Code is not jurisdictional in terms of appellate review of asset sale orders. Rather, section 363(m) is a "statutory limitation" on appellate relief in bankruptcy sales that requires litigants to take certain procedural steps (i.e., seek a stay) to be effective.

Petitioner MOAC Mall Holdings, LLC ("MOAC") was the landlord of a Sears located in the Mall of America. During Sears' bankruptcy proceedings, Sears sold most of its assets to respondent Transform Holdco, LLC ("Transform"), including the right to designate to whom a lease between Sears and MOAC would be assigned. When Transform later designated the Mall of America lease for assignment to its wholly owned subsidiary, MOAC filed an objection, arguing that Sears had not shown adequate assurance of future performance by the assignee as required by section 365 of the Bankruptcy Code. The United States Bankruptcy Court for the Southern District of New York disagreed and approved the assignment, and denied MOAC's request for a stay pending appeal. MOAC appealed the approval of the transfer to the United States District Court for the Southern District of New York. The District Court reversed the Bankruptcy Court, holding that Sears had not satisfied the requirements of section 365 regarding adequate assurance of future performance by Transform. On rehearing, Transform argued (in direct contravention of its prior promise not to) that section 365(m) deprived the District Court of jurisdiction to grant MOAC relief. The District Court determined that Second Circuit precedent bound it to treat section 363(m) as jurisdictional, and thus not subject to waiver or judicial estoppel. The United States Court of Appeals for the Second Circuit affirmed, finding that section 363(m) is jurisdictional.

Justice Jackson, writing for an unanimous Court, noted that jurisdictional rules pertain to the power of the court rather than the rights or obligations of the parties, and as such a statute should only be treated as jurisdictional if Congress "clearly states" as much. The Court analyzed section 363(m) to ascertain whether the text demonstrates Congressional intent to limit judicial power, and determined that no such limitation is present. Nor does section 363(m) have any clear tie to the Bankruptcy Code's jurisdictional provisions. Rather, section 365(m) plainly contemplates that appellate courts may reverse or modify authorized sales under section 363, subject to the caveat that a reversal or modification may not affect the validity of the sale to a good-faith purchaser or lessee under certain prescribed circumstances. Therefore, section 363(m) consists of a "caveated constraint on the effect of a reversal or modification."

The Court also dismissed Transform's mootness claim, noting that a "case becomes moot only when it is impossible for a court to grant any effectual relief whatever to the prevailing party."

II. Section 523(a)(2)(A) of the Bankruptcy Code precludes a debtor from discharging a debt obtained by fraud, regardless of whether the debtor perpetrated the fraud.

In Batenwerfer v. Buckley, 598 U.S. --, 143 S. Ct. 665 (2023), the Supreme Court affirmed the Ninth Circuit's decision that 11 U.S.C. § 523(a)(2)(A), which bars debtors from obtaining a discharge for debts incurred by fraud, applies to debtors even if they did not personally perpetuate the fraud, but are vicariously liable for it and share in the proceeds thereof.

Business partners Kate and David Bartenwerfer jointly purchased a home, remodeled it, and sold it at a profit. David performed most of the remodeling services, but both Kate and David certified, as part of the sale process, that they had disclosed all material facts related to the property. Following the closing of the sale, the buyer, Kieran Buckley, discovered material concealed defects. Buckley commenced suit and obtained a judgment against both sellers for breach of contract, negligence and nondisclosure of material facts. The sellers jointly filed for bankruptcy protection. The bankruptcy court found that the judgment against Kate was non-dischargeable fraud because David's knowing concealment of the home's defects could be imputed to Kate since the two had formed a legal partnership for purposes of the renovation and sale. The Ninth Circuit's Bankruptcy Appellate Panel agreed regarding David's fraudulent intent, but disagreed as to Kate's, finding that Kate was only barred from discharging the debt if she knew or had reason to know of David's fraud. Following another round of evidentiary hearings at the lower courts, the Ninth Circuit ultimately held that a debtor who is liable for her partner's fraud cannot discharge that debt in bankruptcy, regardless of her own culpability.

Justice Barrett delivered the unanimous opinion of the Court affirming the Ninth Circuit. In so doing, the Court undertook a straightforward reading of section 523(a)(2)(A) of the Bankruptcy Code, which uses the passive voice to prevent the discharge of a debt "obtained by fraud" and removes the actor altogether so that the focus is the event, not any actor's intent or culpability. Further, Justice Barrett noted that the common law of fraud has long maintained that fraud liability is not limited to the wrongdoer.

In Batenwerfer, the Supreme Court resolved a circuit split by confirming that, regardless of the debtor's culpability, a debtor may not discharge in bankruptcy a debt obtained by fraud.

III. Nothing in PROMESA categorically abrogates any sovereign immunity the PROMESA Board enjoys from legal claims.

In Financial Oversight and Management Board for Puerto Rico v. Centro de Periodismo Investigativo, Inc., 598 U.S.--, 143 S. Ct. 1176 (2023), a near unanimous Court (with Justice Thomas dissenting) determined that nothing in the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA") abrogates the sovereign immunity enjoyed by the Financial Oversight and Management Board for Puerto Rico (the "Board").

Congress passed PROMESA in 2016 to deal with Puerto Rico's fiscal emergency. The Supreme Court previously held that the Board is part of the local Puerto Rican government; it approves and enforces the Commonwealth's fiscal plans and budgets, supervises its borrowing and represents Puerto Rico in judicial proceedings for restructuring the Commonwealth's debt.

Respondent Centro de Periodismo Investigativo, Inc. ("CPI"), a nonprofit media organization, asked the Board to release various documents relating to its work. The Board did not release the documents, and CPI sued the Board in the United States District Court for Puerto Rico, citing a provision of the Puerto Rican Constitution regarding the right of access to public records. The Board moved to dismiss on sovereign immunity grounds, but the District Court rejected that defense, and the First Circuit affirmed. The lower courts assumed that the Board shares in Puerto Rico's sovereign immunity, but then held that the jurisdictional provision of PROMESA clearly abrogates the Board's immunity.

The opinion penned by Justice Kagan assumed without deciding that Puerto Rico is immune from suit in federal district court, and that the Board partakes of that immunity. The Court addressed only whether, accepting those premises, PROMESA effects an abrogation.

The Court's analysis is a straightforward application of the "clear-statement rule" for finding a congressional abrogation in cases naming the federal government, States and Indian tribes as defendants. The Court notes that this standard is met in only two situations: (1) when the statute says in so many words that it is stripping immunity from a sovereign entity, and (2) when a statute creates a cause of action and authorizes suit against a government on that claim.

Finding that PROMESA fits neither of these two molds, the Court reversed the judgment of the First Circuit and remanded for further proceedings.

In his dissenting opinion, Justice Thomas takes issue with the majority's assumption that Puerto Rico, as a Territory rather than a State, has inherent state sovereign immunity, which is then shared by the Board.

IV. The Bankruptcy Code unambiguously abrogates the sovereign immunity of all governments, including federally recognized Indian tribes.

In Lac Du Flambeau Band of Lake Superior Chippewa Indians v. Coughlin, 599 US --, 143 S.Ct. 1689 (2023), another near unanimous Court (this time, with Justice Gorsuch dissenting) determined that the aforementioned "clear statement rule" was met because the Bankruptcy Code unequivocally abrogates the sovereign immunity of any and every government that possesses the power to assert such immunity. Because federally recognized tribes fit that description, the Bankruptcy Code's abrogation provision plainly applies to them as well.

Petitioner Lac du Flambeau Band of Lake Superior Chippewa Indians (the "Band"), a federally recognized Indian tribe, operates a business known as Lendgreen. Lendgreen extended a payday loan to respondent Brian Coughlin, who filed for protection under Chapter 13 of the Bankruptcy Code shortly after receiving the loan, triggering the automatic stay provisions of section 362 of the Bankruptcy Code. Lendgreen continued collection efforts, and Coughlin filed a motion in the Bankruptcy Court to enforce the automatic stay and recover damages based on the emotional distress caused by the collection efforts. The Bankruptcy Court dismissed the suit on tribal sovereign immunity grounds. In a divided opinion, the First Circuit reversed, concluding that the Bankruptcy Code unequivocally strips tribes of their immunity.

Justice Jackson's opinion focuses on two provisions of the Bankruptcy Code: (1) section 106(a), which abrogates the sovereign immunity of governmental units to a number of Bankruptcy Code provisions, including the provision governing the automatic stay, and (2) section 101(27), which defines governmental unit to include the catchall phrase "other foreign or domestic governments." Taken together, and given that both Congress and the Court have repeatedly characterized tribes as governments, the Court found that Congress clearly intended that the abrogation provision applicable to the automatic stay applies to Indian tribes.

In his dissenting opinion, Justice Gorsuch posits that tribes are neither a foreign government nor a domestic government; rather, tribes have a unique status in the law. As such, Justice Gorsuch finds a clear statement of Congressional intent to abrogate the Band's sovereign immunity lacking.

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