III 2024 - Reading list

A. Case law

1. *Ascentra Holdings, Inc (in official liquidation) and others v SPGK Pte Ltd* [2023] 2 SLR 421

2. *Ascentra Holdings, Inc (in official liquidation) and others v SPGK Pte Ltd* [2024] SGCA 2

3. *Re PT Garuda Indonesia (Persero) Tbk and another matter* [2024] SGHC(I) 1

B. Statutes

4. Select provisions from the Insolvency, Restructuring and Dissolution Act 2018 (No. 40 of 2018), including Schedule 3 (UNCITRAL Model Law On Cross-Border Insolvency)

C. Articles

5. Eidenmuller, Horst. (2018). What is an insolvency proceeding. American Bankruptcy Law Journal, 92(1), 53-72.

6. Zhen Qu, Charles, & Godwin, Andrew. (2019). Does the common law power to grant cross-border insolvency assistance apply to an insolvency winding-up that is voluntary: The reaction to *Singularis* from Singapore and Hong Kong. International Insolvency Review, 28(3), 305-319.

7. Wan, Wai Yee, & McCormack, Gerard. (2020). Implementing strategies for the Model Law on cross-border insolvency: The divergence in Asia-Pacific and lessons for UNCITRAL. Emory Bankruptcy Developments Journal, 36(1), 59-98.

Bankruptcy and Insolvency Act

R.S.C., 1985, c. B-3

An Act respecting bankruptcy and insolvency

Section 2

insolvent person means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and

- **(a)** who is for any reason unable to meet his obligations as they generally become due,
- **(b)** who has ceased paying his current obligations in the ordinary course of business as they generally become due, or

(c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due; (*personne insolvable)*

KeyCite Yellow Flag - Negative Treatment
Distinguished by In re LTL Management LLC, Bankr.W.D.N.C., November 16, 2021

605 B.R. 43
United States Bankruptcy Court, W.D. North Carolina, Charlotte Division.

IN RE BESTWALL LLC, [1] Debtor.

Case No. 17-31795
|
Signed July 29, 2019

Synopsis
Background: Official committee of asbestos claimants filed motion to dismiss debtor's Chapter 11 case as having been filed in bad faith or, alternatively, for change of venue.

Holdings: The Bankruptcy Court, Laura T. Beyer, Chief Judge, held that:

[1] court could not dismiss, as having been filed in bad faith, a Chapter 11 case filed by debtor which had ability to receive funds from newly-created corporate entity from which asbestos-related liabilities had been spun off, and

[2] neither the interests of justice nor the convenience of the parties warranted transferring venue of Chapter 11 case that debtor had filed in judicial district where it was domiciled and where many of its assets were located.

Motion denied.

Procedural Posture(s): Motion to Convert or Dismiss Case; Motion to Transfer or Change Venue.

West Headnotes (18)

[1] **Bankruptcy** "Bad faith."
Bankruptcy Realistic possibility of reorganization

Court may dismiss a Chapter 11 case as having been filed in bad faith only when the bankruptcy reorganization is both (1) objectively futile, and (2) filed in subjective bad faith. 11 U.S.C.A. § 1112(b).

2 Cases that cite this headnote

[2] **Bankruptcy** "Bad faith."
Bankruptcy Realistic possibility of reorganization

Stringent standard for dismissal of Chapter 11 case as having been filed in bad faith recognizes that it is better to risk proceeding with a wrongly motivated invocation of Chapter 11 protections whose futility is not immediately manifest than to risk cutting off even a remote chance that reorganization effort so motivated might nevertheless yield a successful rehabilitation, and that it is also better to risk the wastefulness of a probably futile, but good faith, effort to reorganize than it is to risk error in prejudging its futility at the threshold. 11 U.S.C.A. § 1112(b).

[3] **Bankruptcy** Proceedings

Moving party bears the burden of establish “cause” for dismissal of Chapter 11 case under “for cause” dismissal provision. 11 U.S.C.A. § 1112(b).

[4] **Bankruptcy** In General; Grounds in General

Bankruptcy court's power under “for cause” dismissal provision to dismiss a Chapter 11 case at its outset is one to be exercised with great care and caution. 11 U.S.C.A. § 1112(b).

3 Cases that cite this headnote

[5] **Bankruptcy** Dismissal

Decisions denying access at very portals of bankruptcy, before an ongoing proceeding has even begun to develop the total shape of debtor's situation, are inherently drastic and not to be made lightly.

4 Cases that cite this headnote

[6] **Bankruptcy** Realistic possibility of reorganization

In deciding whether reorganization is "objectively futile," as required for court to dismiss a Chapter 11 case under "for cause" provision as filed in bad faith, court should concentrate on assessing whether there is no going concern to preserve and no hope of rehabilitation, except according to the debtor's terminal euphoria. 11 U.S.C.A. § 1112(b).

[7] **Bankruptcy** "Bad faith."

Filing for Chapter 11 relief, especially in the face of asbestos or mass tort claims, need not be due to insolvency; attempting to resolve asbestos claims through a Chapter 11 plan and channeling injunction is a valid reorganizational purpose, of kind weighing against dismissal of case as bad faith filing. 11 U.S.C.A. §§ 524(g), 1112(b).

3 Cases that cite this headnote

[8] **Bankruptcy** Realistic possibility of reorganization

Bankruptcy court could not dismiss, as having been filed in bad faith, a Chapter 11 case filed by debtor which had ability to receive funds, from newly-created corporate entity from which asbestos-related liabilities had been spun off as part of prepetition corporate restructuring, in an amount sufficient to pay costs of Chapter 11 case and to fund asbestos trust; court could not say that debtor's reorganization efforts were objectively futile, especially where debtor had significant assets of its own. 11 U.S.C.A. §§ 524(g), 1112(b).

2 Cases that cite this headnote

[9] **Bankruptcy** Change or Transfer of Venue

When venue of Chapter 11 case is valid, the debtor's choice of forum is to be accorded substantial weight and deference. 28 U.S.C.A. §§ 1408, 1409.

1 Case that cites this headnote

[10] **Bankruptcy** Change or Transfer of Venue

When venue of bankruptcy case is entirely appropriate, bankruptcy court exercises its power to transfer cases cautiously. 28 U.S.C.A. §§ 1408, 1409.

1 Case that cites this headnote

[11] **Bankruptcy** Presumptions and burden of proof

Bankruptcy Weight and sufficiency

Debtor's choice of forum for bankruptcy case is presumed to be a proper district for venue purposes, and a party challenging a debtor's choice must show, by preponderance of the evidence, that venue is improper. 28 U.S.C.A. §§ 1408, 1409.

1 Case that cites this headnote

[12] **Bankruptcy** Chapter 11 cases

Neither the interests of justice nor the convenience of the parties warranted transferring venue of Chapter 11 case that debtor had filed in judicial district where it was domiciled and where many of its assets were located, where retaining the case in the judicial district chosen by debtor best promoted the efficient administration of estate because, among other things, it avoided the superfluous administrative expenses and delay associated with transferring case that had been pending in that district for over a year, and where debtor's creditors, consisting largely of asbestos injury claimants, were spread throughout the country, and the proposed alternate forum was no more convenient than that chosen by debtor. 28 U.S.C.A. § 1412.

[13] **Bankruptcy** Factors, grounds, and objections in general

"Interests of justice" standard for transferring venue of bankruptcy case is applied based on the facts and circumstances of each case. 28 U.S.C.A. § 1412.

[14] **Bankruptcy** Factors, grounds, and objections in general

Courts consider a variety of factors in deciding whether to transfer venue of bankruptcy case in the interests of justice: (1) whether transfer promotes economic and efficient administration of bankruptcy estate; (2) whether transfer facilitates judicial economy; (3) the parties' ability to receive a fair trial in either venue; (4) whether either forum has an interest in deciding controversies within its jurisdictional borders; (5) whether a transfer would affect the enforceability of any judgment rendered; and (6) whether debtor's original choice of forum should be disturbed. 28 U.S.C.A. § 1412.

2 Cases that cite this headnote

[15] **Bankruptcy** Factors, grounds, and objections in general

Key consideration in deciding whether to transfer venue of bankruptcy court in the interests of justice is whether transferring venue would promote the efficient administration of the bankruptcy estate, judicial economy, timeliness, and fairness. 28 U.S.C.A. § 1412.

2 Cases that cite this headnote

[16] **Bankruptcy** Factors, grounds, and objections in general

Courts evaluate six factors in determining whether to transfer venue of bankruptcy case for the convenience of the parties: (1) proximity of creditors of every kind to the court; (2) proximity of debtor to the court; (3) proximity of witnesses necessary to administration of estate; (4) location of assets; (5) economic administration of estate; and (6) the necessity for ancillary administration if a liquidation should occur. 28 U.S.C.A. § 1412.

2 Cases that cite this headnote

[17] **Bankruptcy** Factors, grounds, and objections in general

Consideration that is given the most weight in deciding whether to transfer venue of bankruptcy case for the convenience of the parties is the economic and efficient administration of bankruptcy estate. 28 U.S.C.A. § 1412.

1 Case that cites this headnote

[18] **Bankruptcy** Factors, grounds, and objections in general

In deciding whether to transfer venue of bankruptcy case for the convenience of the parties, courts consider the learning curve of a case if transferred and the ability of interested parties to participate in the proceedings and the additional costs that might be incurred in doing so. 28 U.S.C.A. § 1412.

Attorneys and Law Firms

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MEMORANDUM OPINION AND ORDER DENYING THE OFFICIAL COMMITTEE OF ASBESTOS CLAIMANTS' MOTION FOR DISMISSAL, OR ALTERNATIVELY, VENUE TRANSFER

Laura T. Beyer, United States Bankruptcy Judge

***46** On November 9, 2018 and January 24, 2019, the Court convened hearings on the *Motion of the Official Committee of Asbestos Claimants to (I) Dismiss the Debtor's Chapter 11 Case for Cause as a Bad Faith Filing Pursuant to 11 U.S.C. § 1112(b), or Alternatively, (II) Transfer Venue in the Interest of Justice and for the Convenience of the Parties Pursuant to 28 U.S.C. § 1412* [Docket No. 495] (the "Motion"). For the reasons set forth below, the Court denies the Motion.

PROCEDURAL HISTORY

On November 2, 2017 (the "Petition Date"), Bestwall LLC ("Bestwall") filed a voluntary petition for relief under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code") in this district, initiating the above-captioned case to resolve mass asbestos claims through a section 524(g) trust. Shortly after the Petition Date, this Court approved the appointment of the Official Committee of Asbestos Claimants (the "Committee") to represent the asbestos claimants in the Chapter 11 case, and thereafter has approved modifications to the Committee [Docket Nos. 97, 335, 348, 666, 690].

On August 15, 2018, the Committee filed the Motion requesting that the Court dismiss Bestwall's bankruptcy case as a bad faith filing pursuant to section 1112(b) of the Bankruptcy Code. Alternatively, the Committee requested that the Court transfer venue of this case in the interests of justice or for the convenience of the parties, pursuant to 28 U.S.C. § 1412.

In connection with the Court's consideration of the Motion, Bestwall, the Committee, the Future Claimants' Representative, and Bestwall's non-debtor affiliate, Georgia-Pacific LLC ("New GP"), stipulated to the admission into evidence of the *Debtor's Submission in Lieu of Live Testimony* [Docket No. 651] (the "Submission"). See Submission, pp. 2, 26; see also *Transcript of Proceedings Before the Honorable Laura Turner Beyer*, *United States Bankruptcy Judge* (November 9, 2018) (the "November Transcript"), p. 42. Bestwall also submitted the *Declaration of Gregory M. Gordon* [Docket No. 641] (the "Gordon Declaration") into evidence, and no objections were made to its admission. See November Transcript, p. 42. Bestwall and the Committee fully briefed this matter [2] and ***47** presented oral arguments with respect to the Motion at the November 9, 2018 hearing.

JURISDICTION

This Court has subject matter jurisdiction to consider this matter pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b). Venue in this Court is proper pursuant to 28 U.S.C. §§ 1408 and 1409.

RELEVANT FACTS

The former Georgia-Pacific LLC ("Old GP"), the predecessor to Bestwall, had a decades-long history of asbestos litigation that derived from its acquisition of Bestwall Gypsum Co. ("Old Bestwall"). Submission at ¶¶ 22-23. Old Bestwall manufactured and sold certain asbestos-containing products, principally joint compound, and Old GP continued to manufacture and sell those products following the acquisition. Id. The magnitude and projected continuation of that litigation through at least 2050 ultimately led Old GP to undertake a corporate restructuring on July 31, 2017 (the "2017 Corporate Restructuring"). Id. at ¶ 13.

The 2017 Corporate Restructuring was effectuated through a Texas divisional merger. [3] As a result of that divisional merger, Old GP ceased to exist and two new companies were formed: [4]

a) Bestwall (the debtor in this case), which received certain assets and liabilities of Old GP, including (i) Old GP's asbestos liabilities (with the exception of claims made under a workers' compensation statute or similar laws) and (ii) certain assets related to the historical Old Bestwall business; and

b) New GP, which received the other businesses, assets, and liabilities of Old GP, most of which are unrelated to Old Bestwall's historical business.

Id. at ¶ 14.

As of the Petition Date, approximately 64,000 asbestos claims were pending against Bestwall, and Bestwall projected that tens of thousands of additional claims would continue to be filed or asserted against it every year through at least 2050. Submission at ¶¶ 23, 29.

Through the 2017 Corporate Restructuring, Bestwall received, among others, the following tangible assets:

a) three bank accounts with approximately $32 million in cash at the time of the transaction;

b) all contracts of Old GP related to its asbestos-related litigation;

c) certain real estate in Mt. Holly, North Carolina; and

d) all equity interests in non-debtor GP Industrial Plasters LLC, a North Carolina limited liability company ("PlasterCo"), which owns certain assets of Old Bestwall's historical business, is projected to generate annual cash flow (EBITDA) of $18 million starting in 2019, and whose equity was valued at approximately $145 million prior to the Petition Date.

Id. at ¶ 15.

As part of the 2017 Corporate Restructuring, Bestwall also became party to a funding agreement with New GP (the "Funding Agreement"). Id.; see Gordon Declaration at ¶ 7, Ex. A. Without any corresponding repayment obligation by Bestwall, the Funding Agreement requires New GP to provide funding to pay for all ***48** costs and expenses of the Debtor incurred in the normal course of its business during the pendency of its Chapter 11 case, including the costs of administering the Chapter 11 case, to the extent that any cash distributions received by Bestwall from its subsidiaries are insufficient to pay such costs and expenses. In addition, and again in the absence of any corresponding repayment obligation by Bestwall, the Funding Agreement requires New GP to provide the funding for a section 524(g) asbestos trust in the amount required by a confirmed plan of reorganization for Bestwall to the extent that Bestwall's assets are insufficient to provide the requisite trust funding. Submission at ¶ 17. In light of the Funding Agreement, which allows the Debtor to draw from New GP the amount of money necessary to pay the costs of this Chapter 11 case and to fund a section 524(g) trust, to the extent the Debtor's assets are insufficient to do so, there is no reason for the Court to conclude, at this point, that the Debtor does not have the ability to fully fund a section 524(g) trust, as well as the administrative costs of its Chapter 11 case.

DISCUSSION

I. Dismissal Is Not Appropriate.

A. Legal Standard

[1] In the Fourth Circuit, a court may dismiss a Chapter 11 filing as a bad faith filing only when the bankruptcy reorganization is both (i) objectively futile *and* (ii) filed in subjective bad faith. Carolin Corp. v. Miller, 886 F.2d 693, 700-01 (4th Cir. 1989).

[2] "Th[is] Fourth Circuit standard for dismissal of a Chapter 11 case as a bad faith filing is one of the most stringent articulated by the federal courts." In re Dunes Hotel Assocs., 188 B.R. 162, 168 (Bankr. D.S.C. 1995). As the Fourth Circuit stated in Carolin, this two-prong test:

> contemplates that it is better to risk proceeding with a wrongly motivated invocation of Chapter 11 protections whose futility is not immediately manifest than to risk cutting off even a remote chance that a reorganization effort so motivated might nevertheless yield a successful rehabilitation. Just as obviously, it contemplates that it is better to risk the wastefulness of a probably futile but good faith effort to reorganize than it is to risk error in prejudging its futility at the threshold.

886 F.2d at 701.

[3] The moving party "has the burden of proof to establish cause for dismissal." In re Woodend, LLC, No. 11-31672, 2011 WL 3741071, at *3 (Bankr. W.D.N.C. Aug. 24, 2011) (citing In re Landmark Atl. Hess Farm, LLC, 448 B.R. 707 (Bankr. Md. 2011)); see also In re SUD Props., Inc., 462 B.R. 547, 551 (Bankr. E.D.N.C. 2011) ("First Bank [the movant] bears the burden of demonstrating both objective futility and subjective bad faith by a preponderance of the evidence."); In re Surf City Invs., LLC, No. 11-01398-8-RDD, 2011 WL 5909489, at *4 (Bankr. E.D.N.C. May 6, 2011) (same).

[4] **[5]** "The Carolin court made clear that the burden of establishing this two-pronged requirement is very high." Dunes Hotel, 188 B.R. at 168. The power to dismiss a bankruptcy petition at the outset of a case "is obviously one to be exercised with great care and caution. Decisions denying access at the very portals of bankruptcy, before an ongoing proceeding has even begun to develop the total shape of the debtor's situation, are inherently drastic and not lightly to be made." Carolin, 886 F.2d at 700.

***49** B. Analysis

1. Objective Futility

[6] Per Carolin, the "objective futility inquiry" should "concentrate on assessing whether there is no going concern to preserve ... and ... no hope of rehabilitation, except according to the debtor's 'terminal euphoria.' " Carolin, 886 F.2d at 701-02 (citation omitted); see also In re Woodend, LLC, 2011 WL 3741071, at *3 (Bankr. W.D.N.C. Aug. 24, 2011) (objective futility prong "focuses on the debtor's financial stability, whether there exists a going concern to preserve, and whether there exists any realistic hope of rehabilitation") (citing Carolin, 886 F.2d at 701).

[7] Attempting to resolve asbestos claims through 11 U.S.C. § 524(g) is a valid reorganizational purpose, and filing for Chapter 11, especially in the context of an asbestos or mass tort case, need not be due to insolvency. The Committee agrees. Committee's Reply at p. 11 ("agree[ing] that section 524(g) may provide a sufficient business purpose for an otherwise solvent debtor to seek Chapter 11 relief"). The volume of current asbestos claims that Bestwall faced as of the Petition Date, coupled with the projected number of claims to be filed through 2050 and beyond, is sufficient financial distress for Bestwall to seek resolution under section 524(g) of the Bankruptcy Code. See Submission at ¶ 23.

[8] Bestwall has the ability to reorganize and establish a trust that meets each of the statutory requirements of section 524(g) of the Bankruptcy Code. Bestwall has substantial assets, owns ongoing active businesses, and receives substantial cash flow. Id. at ¶¶ 15-16. Most importantly, Bestwall has the full ability to meet all of its obligations (whatever they may be) through its assets and New GP's assets, which are available through the Funding Agreement, (id. at ¶ 17), and to continue as a going concern.

The Committee argues that the Court should disregard the Funding Agreement and other support agreements between Bestwall and New GP and that without the Funding Agreement, Bestwall would be unable to reorganize. But the Funding Agreement exists and is enforceable; it cannot be disregarded.

Further, there is no requirement that Bestwall fund the entirety of a section 524(g) trust with its own assets or securities. Section 524(g)(2)(B)(i)(II) contemplates funding through non-debtor sources and requires that a trust be funded "in whole *or in part* by the securities of 1 or more debtors involved in such plan and by the obligation of such debtor or debtors to make future payments" (emphasis added). Indeed, there are multiple section 524(g) cases where trust funding was provided by non-debtors. E.g., In re Mid-Valley, 305 B.R. 425 (Bankr. W.D. Pa. 2004); In re N. Am. Refractories Co., 2007 WL 7645287 (Bankr. W.D. Pa. Nov. 13, 2007); W.R. Grace, Case No. 01-1139 (Bankr. D. Del. 2001).

Alternatively, the Committee contends that the Funding Agreement's protections are illusory and insufficient. However, the terms of the Funding Agreement and the evidence of record demonstrate the opposite. The Funding Agreement is a binding and enforceable contractual obligation. New GP has performed all of its obligations under the Funding Agreement to date and New GP repeatedly has reaffirmed its commitment to honor those obligations going forward. And contrary to the Committee's assertion that New GP has refused to provide information about its finances, Bestwall has worked with New GP to provide both the Committee and the Future Claimants' Representative with New GP's 2017 audited financial statement ***50** and certain other requested financial information for New GP, including balance sheets, income statements, cash flow statements, and financial projections. See Gordon Declaration at ¶ 3.

The Committee has not pointed to any evidence that either party to the Funding Agreement has acted other than in full compliance with its terms. Rather, the Committee presents scenarios to suggest that, were it so motivated, New GP might seek to evade its performance obligations. While the Court may share some of those concerns, they are unsubstantiated and insufficient for dismissal. Any issues and concerns about the Funding Agreement can be addressed in the plan confirmation process.

Even outside of the Funding Agreement, Bestwall owns substantial assets and operating businesses that produce cash flow. These include bank accounts that contain approximately $20 million in cash, real estate that generates monthly lease revenue, and, most materially, the equity interest in non-debtor PlasterCo, which is projected to generate $18 million in annual EBITDA in 2019 and beyond and whose equity is valued at approximately $145 million. Submission at ¶¶ 15-16. Unlike the debtor in In re W. Asbestos Co., 313 B.R. 832 (Bankr. N.D. Cal. 2003), relied upon by the Committee, Bestwall is not a "defunct company." Id. at 852. Bestwall owns a substantial operating business that generates cash flow; it has the ability to make future payments as required by section 524(g)(2)(B)(i)(II) of the Bankruptcy Code.

For those same reasons (i.e., Bestwall owns assets and businesses that generate revenue), Bestwall satisfies any applicable "ongoing business requirement" in sections 524(g) and 1141(d)(3) of the Bankruptcy Code. The Committee argues that Bestwall cannot satisfy the ongoing business requirement because it is a holding company. The Court disagrees. Bestwall owns substantial operations through its non-debtor subsidiaries, and there is nothing novel about a holding company filing for Chapter 11 relief. Numerous Chapter 11 debtors, including those who have successfully established section 524(g) trusts, were holding companies with non-debtor operating subsidiaries. See, e.g., In re Gulfmark Offshore, Inc., Case No. 17-11125 (Bankr. D. Del. 2017); In re Specialty Prods. Holding Corp., Case No. 10-11780 (Bankr. D. Del. 2010); In re DDI Corp., Case No. 03-15261 (Bankr. S.D.N.Y. 2003); In re XO Commc'ns, Inc., Case No. 02-12947 (Bankr. S.D.N.Y. 2002); In re Williams Commc'ns Grp., Inc., Case No. 02-11957 (Bankr. S.D.N.Y. 2002); In re NII Holdings, Inc., 288 B.R. 356 (Bankr. D. Del. 2002); In re Mercury Finance Co., 224 B.R. 380 (Bankr. N.D. Ill. 1998).

In addition to holding subsidiary stock worth approximately $145 million, Bestwall has millions of dollars in cash of its own. It also has the Funding Agreement—which permits Bestwall to draw from New GP an uncapped amount of money to pay the costs of this Chapter 11 case and fund Bestwall's liabilities to the extent that its assets are insufficient to do so. Because Bestwall has the resources with which to reorganize, this case is not objectively futile and dismissal is not appropriate.

Finally, the Committee raises concerns about the delay caused by this case and the claimants' inability to proceed with litigation in state court. But the claimants represented by the Committee are not necessarily worse off with this Chapter 11 case. Their claims can be sufficiently addressed and fairly adjudicated through a section 524(g) trust.

2. Subjective Bad Faith

Because the Court concludes that this case is not objectively futile, it need not (and does not) reach the issue of whether ***51** this case was filed in subjective bad faith. The Court will ultimately have to rule on Bestwall's good faith, albeit in a different context, at confirmation.

II. Venue Transfer Is Not Appropriate.

Alternatively, the Committee requests, pursuant to 28 U.S.C. § 1412, that the Court transfer venue of this case to Delaware or another appropriate venue either (a) in the interests of justice or (b) for the convenience of the parties.

As an initial matter, venue in this Court is proper pursuant to 28 U.S.C. §§ 1408 and 1409. Bestwall formed as a Texas limited liability company on July 31, 2017 and then transferred its domicile to North Carolina 94 days prior to the Petition Date – i.e., for a longer portion of the 180-day period required by 28 U.S.C. § 1408. See Submission at ¶ 14. The Committee has acknowledged that the Debtor has, technically, complied with the statutory venue provisions. Motion, at ¶ 47.

[9] **[10]** Where, as here, the venue of a Chapter 11 case is valid, the "debtor's [ ] choice of forum [is to] be accorded substantial weight and deference." In re PWS Holding Corp., Case Nos. 98-212-SLR through 98-223-SLR, 1998 Bankr. LEXIS 549, at *4-5 (Bankr. D. Del. Apr. 28, 1998); see also In re Enron Corp., 284 B.R. 376, 386 (Bankr. S.D.N.Y. 2002) (same). "[W]here the existing venue is entirely appropriate, this Court exercises its power to transfer cases cautiously." In re Land Stewards, L.C., 293 B.R. 364, 369 (Bankr. E.D. Va. 2002).

[11] A debtor's choice of forum is presumed to be "a proper district for venue purposes and the party challenging a debtor's choice must show by a *preponderance of the evidence* that the venue is improper." In re Honeycutt, No. 12-06921-8-JRL, 2012 WL 6681833, at *2, 2012 Bankr. LEXIS 5857, at *6-7 (Bankr. E.D.N.C. Dec. 21, 2012) (citations omitted) (emphasis added); see also In re Baltimore Food Sys., Inc., 71 B.R. 795, 798 (Bankr. D.S.C. 1986).

[12] The Committee has failed to carry its burden: Neither the interests of justice nor the convenience of the parties warrants transferring venue of this case.

A. Interests of Justice

[13] **[14]** The interests of justice standard "is applied based on the facts and circumstances of each case." Enron Corp., 284 B.R. at 403 (citation omitted). Courts consider a variety of factors, such as: (1) whether transfer promotes the economic and efficient administration of the bankruptcy estate; (2) whether transfer facilitates judicial economy; (3) the parties' ability to receive a fair trial in either venue; (4) whether either forum has an interest in deciding controversies within its jurisdictional borders; (5) whether transfer would affect the enforceability of any judgment rendered; and (6) whether the debtor's original choice of forum should be disturbed. See Brown v. Wells Fargo, NA, 463 B.R. 332, 338 (M.D.N.C. 2011).

[15] Ultimately, the key consideration is "whether transferring venue would promote the efficient administration of the bankruptcy estate, judicial economy, timeliness, and fairness." In re Manville Forest Prods. Corp., 896 F.2d 1384, 1391 (2d Cir. 1990); see also Yolo Capital, Inc. v. Normand, No. 1:17-CV-00180-MR DLH, 2018 WL 576316, at *2 (W.D.N.C. Jan. 26, 2018) ("Not all of these [interest of justice] factors are weighed equally, however, as the most important of these factors is the economic and efficient administration of the estate.") (citing Hilton Worldwide, Inc. v. Global Benefits Admin. Comm. v. Caesars Entm't Corp., 532 B.R. 259, 274 (E.D. Va. 2015)).

***52** Of all the factors that apply, they all weigh against transferring venue. Bestwall is neither organized in Delaware, nor does it have its principal place of business or assets there. Bestwall is domiciled in the Western District of North Carolina, and many of its assets are here. Most importantly, retaining the case in this district best promotes the efficient administration of Bestwall's estate because, among other things, it avoids the superfluous administrative expenses and delay associated with transferring a case that has been pending in this district for over a year (by the time of the hearing on the Motion) to a court in another district. See In re Pavilion Place Assocs., 88 B.R. 32, 35 (Bankr. S.D.N.Y. 1988) (explaining that "transfer is a cumbersome disruption of the [C]hapter 11 process") (citations omitted).

In support of its Motion, the Committee cites the Patriot Coal case from the Southern District of New York. See 482 B.R. 718 (Bankr. S.D.N.Y. 2012). Patriot Coal, however, is distinguishable and does not support a transfer of venue in this case. In Patriot Coal, the debtors created, on the eve of bankruptcy, two New York domiciled shell entities with essentially no assets to take advantage of the "affiliate filing rule" to permit the entire corporate family to file in New York. The New York entities were not the relevant entities for the Chapter 11 restructuring (i.e., they were not the entities with the operations and debt in need of restructuring); they were just a tool to allow affiliates with businesses outside of New York to file in the preferred court.

Here, Bestwall did not take advantage of the status of any of its affiliates to manufacture venue. In fact, no affiliates filed at all, and Bestwall is the only debtor. Further, Bestwall is not a shell company, as were the entities created in Patriot Coal. Instead, Bestwall has substantial assets. As a result, there were important legal consequences to the selection of a state to govern Bestwall's formation. Among other things, the decision to organize Bestwall in North Carolina (1) subjected it to the laws of North Carolina, (2) impacted its fiduciary obligations and the standards that govern indemnification and exculpation of its officers and directors, (3) required the payment of franchise taxes to North Carolina, and (4) created oversight of Bestwall by North Carolina governmental authorities. As a result, Bestwall accepted not just the potential benefits of organizing in North Carolina, but any legal burdens as well. This was not the case in Patriot Coal, where the newly created entities had no true assets.

Further, Bestwall is not itself an operating company like the primary debtors in Patriot Coal. As a result, where Bestwall's Chapter 11 case should be venued "in the interest of justice" is a less relevant question than when a debtor files in a jurisdiction that is separate from where it actually conducts its operations. A court in this district expressly recognized as much in its decision denying a transfer of venue of another pending asbestos case, In re Kaiser Gypsum Co., Inc., No. 16-31602 (Bankr. W.D.N.C. Jan. 30, 2017). See *Order Denying Motion of Certain Kaiser Gypsum Claimants to Transfer Chapter 11 Cases to the United States District Court for the Western District of Washington* [Docket No. 348] (Decl. Ex. Y).

As in Kaiser Gypsum, there is no compelling basis to transfer venue in the interests of justice because Bestwall is not operating a business with numerous employees, vendors, customers, and tangible assets in a separate location, which was the concern leading to a venue transfer in Patriot Coal.

The Committee has not shown by a preponderance of the evidence that Bestwall's ***53** case should be transferred to Delaware or any other venue in the interests of justice.

B. Convenience of the Parties

The Committee also argues that this case should be transferred to the District of Delaware or any other appropriate jurisdiction for the convenience of the parties.

[16] **[17]** **[18]** Courts evaluate six factors in determining convenience of the parties: "(1) the proximity of creditors of every kind to the court; (2) the proximity of the Debtor to the court; (3) the proximity of the witnesses necessary to the administration of the estate; (4) the location of the assets; (5) the economic administration of the estate; and (6) the necessity for ancillary administration if a liquidation should occur." In re Lakota Canyon Ranch Dev., LLC, Case No. 11-03739-8, 2011 WL 5909630, at *3 (Bankr. E.D.N.C. 2011). "The consideration given the most weight is the economic and efficient administration of the estate." In re Dunmore Homes, Inc., 380 B.R. 663, 672 (Bankr. S.D.N.Y. 2008). Courts have also considered the learning curve of a case if transferred and the ability of interested parties to participate in the proceedings and the additional costs that might be incurred in doing so. Id.

Here, the factors do not support a transfer of venue. Bestwall's creditors are not located in, or clustered around, Delaware. They are spread throughout the country. Thus, Delaware is no more convenient to asbestos claimants than North Carolina or any other state. None of Bestwall's representatives are located in Delaware. In fact, Bestwall's headquarters in Atlanta is closer to Charlotte than to Delaware. None of the known potential witnesses in this case, including any representatives of Bestwall or New GP, are located in Delaware. Similarly, none of Bestwall's tangible assets are located in Delaware; they, instead, are located in North Carolina.

The Committee argues that convenience of the parties is supported by the location of its own counsel and counsel to the Future Claimants' Representative in Delaware. But location of counsel to a party in interest selected by that party after the filing of the Chapter 11 case has no bearing on venue. See In re Great Am. Res., Inc., 85 B.R. 444, 446 (Bankr. N.D. Ohio 1988) ("venue decisions should not merely shift the inconvenience from one party to another") (citations omitted).

The Committee also argues that "economic and efficient administration of the estate" supports transfer to the District of Delaware. The Committee's position is that the case should be transferred to Delaware because courts within the Third Circuit have significant experience with, and a comprehensive body of case law governing, asbestos bankruptcies. But nowhere does the Committee cite any case law that stands for the proposition that the existence of case law in another jurisdiction justifies the transfer of a properly venued Chapter 11 case "for the convenience of the parties." Moreover, courts in this jurisdiction have experience with asbestos-related Chapter 11 cases, including the Garlock and Kaiser Gypsum Chapter 11 cases, as well as the body of law that exists from the Fourth Circuit on mass tort cases. See In re Garlock Sealing Tech., LLC, 504 B.R. 71 (Bankr. W.D.N.C. 2014); In re Kaiser Gypsum Co., Inc., Case No. 16-31602 (Bankr. W.D.N.C. 2016); Grady v. A.H. Robins Co., Inc., 839 F.2d 198 (4th Cir. 1988); In re A.H. Robins Co., Inc., 880 F.2d 694 (4th Cir. 1989).

The Committee has not shown by a preponderance of the evidence that Bestwall's case should be transferred to Delaware or any other jurisdiction for the convenience of the parties.

*54 CONCLUSION

For reasons presented in this Memorandum Opinion and Order, and for the reasons stated in the Court's oral ruling on the record at the January hearing:

1. The Committee's Motion is **DENIED**.

2. This Memorandum Opinion and Order shall be immediately effective and enforceable upon its entry.

3. This Court shall retain exclusive jurisdiction over any and all matters arising from or related to the implementation, interpretation, or enforcement of this Memorandum Opinion and Order.

SO ORDERED.

All Citations

605 B.R. 43

Footnotes

1 The last four digits of the Debtor's taxpayer identification number are 5815. The Debtor's address is 133 Peachtree Street, N.E., Atlanta, GA 30303.

2 The parties filed the following briefs in support of or in objection to the Motion:

- *The Debtor's Objection to Motion of the Official Committee of Asbestos Claimants to Dismiss the Chapter 11 Case, or Alternatively, Transfer Venue* [Docket No. 640] ("Bestwall's Objection");

- *The Official Committee of Asbestos Claimants' Omnibus Reply in Support of Its Motion to (I) Dismiss the Debtor's Chapter 11 Case for Cause as a Bad Faith Filing Pursuant to 11 U.S.C. § 1112(b), or Alternatively, (II) Transfer Venue in the Interest of Justice and for the Convenience of the Parties Pursuant to 28 U.S.C. § 1412* [Docket No. 653] (the "Committee's Reply"); and

- *The Debtor's Sur-Reply in Support of Its Objection to Motion of the Official Committee of Asbestos Claimants to Dismiss the Chapter 11 Case, or Alternatively, Transfer Venue* [Docket No. 659] ("Bestwall's Sur-Reply").

3 See Tex. Bus. Orgs. Code § 1.002(55)(A).

4 See Gordon Declaration at ¶ 28, Ex. Z.

End of Document

2024 WL 721596
Only the Westlaw citation is currently available.
United States Bankruptcy Court, W.D. North Carolina, Charlotte Division.

IN RE: BESTWALL LLC, Debtor.

Case No. 17-31795
|
Signed February 21, 2024

Synopsis
Background: Claimants and official committee of asbestos claimants moved to dismiss debtor's Chapter 11 case as having been filed in bad faith or, alternatively, for change of venue, and that motion was denied, 605 B.R. 43. Claimants and committee moved to reconsider.

Holdings: The Bankruptcy Court, Laura T. Beyer, Chief Judge, held that:

[1] law of case prevented reconsideration of prior decision that resolving asbestos claims was valid reorganizational purpose;

[2] divestment rule prevented Court from addressing issues on interlocutory appeal; and

[3] financial distress was not prerequisite for bankruptcy subject matter jurisdiction pursuant to Constitution.

Motion denied.

Procedural Posture(s): Motion for Reconsideration; Motion to Dismiss for Lack of Subject Matter Jurisdiction.

West Headnotes (28)

[1] Bankruptcy

Law of case prevented reconsideration of bankruptcy court's prior decision on motion to dismiss that resolving asbestos claims was valid reorganizational purpose for debtor with resources with which to reorganize, and Chapter 11 petition was not objectively futile based on volume of current asbestos claims coupled with number of claims to be filed, since claimant did not cite to substantially different evidence sufficient to cause court to revisit its prior opinion and order. 11 U.S.C.A. §§ 524(g), 1112(b).

[2] Judgment

Pursuant to the law of the case doctrine and in the interest of finality, when a court decides upon a rule of law, that decision should continue to govern the same issues in subsequent stages in the same case.

[3] Judgment

To determine extent to which law of case governs, court first must determine what issues it decided in opinion and order and then decide whether any exceptions apply that might justify departing from law of case.

[4] Bankruptcy

A Chapter 11 debtor with substantial asbestos liabilities may obtain a channeling injunction that diverts all asbestos claims, current and future, to a trust established by the debtor's reorganization plan and funded by the debtor. 11 U.S.C.A. § 524(g).

[5] Federal Courts

Generally, the timely filing of a notice of appeal confers jurisdiction on the court of appeals and divests the district court of its control over those aspects of the case involved in the appeal; the purpose of the general rule is to avoid the confusion of placing the same matter before two courts at the same time and to preserve the integrity of the appeal process.

[6] Bankruptcy

Bankruptcy court is divested of jurisdiction with respect to matters raised in an appeal to a higher court.

[7] **Bankruptcy**

Divestment rule prevented bankruptcy court, on claimant's motion for reconsideration of prior denial of motion by official committee of asbestos claimants to dismiss, from addressing issues on interlocutory appeal of that denial, since crux of both motions was determination of whether Chapter 11 case should be dismissed as bad faith filing, reasoning previously argued and decided was same as reasoning subsequently argued, i.e., case lacked valid bankruptcy purpose, manipulated Bankruptcy Code and bankruptcy jurisdiction, and deprived victims of jury trial rights, and exercising jurisdiction over motion would interfere with or effectively circumvent appeal process. 11 U.S.C.A. §§ 524(g), 1112(b).

[8] **Bankruptcy**

When a notice of appeal has been filed in a bankruptcy case, the bankruptcy court retains jurisdiction to address elements of the bankruptcy proceeding that are not the subject of that appeal.

[9] **Federal Courts**

Once an appeal is pending, it is imperative for a lower court to not exercise jurisdiction over those issues which, although not themselves expressly on appeal, nevertheless so impact the appeal so as to interfere with or effectively circumvent the appeal process.

[10] **Federal Courts**

Interlocutory appeals do not divest lower courts of jurisdiction.

[11] **Federal Courts**

Issues of subject matter jurisdiction may be resurrected at any point in litigation.

[12] **Federal Courts**

Bankruptcy court and all federal courts have limited jurisdiction and can exercise power only as authorized by Constitution and Congress.

[13] **Federal Courts**

Subject matter jurisdiction sets outer limit of a federal court's authority, and nonjurisdictional rules control within jurisdictional boundaries.

[14] **Bankruptcy**

Bankruptcy Clause of the Constitution determines limits of subject matter jurisdiction for bankruptcy. U.S. Const. art. 1, § 8, cl. 4.

[15] **Federal Courts**

Congress determines subject matter jurisdiction within any limitations imposed by the Constitution.

[16] **Federal Courts**

Party advocating in favor of a court's subject matter jurisdiction over a particular case or issue bears the burden of proof.

[17] **Federal Courts**

Subject matter jurisdiction cannot be defeated by equitable defenses because it can be raised at any time and is requirement for federal courts to exercise their power.

[18] **Federal Courts**

Concepts of consent, waiver, and estoppel do not apply to subject matter jurisdiction because it is created and limited by the Constitution and statutes.

[19] **Federal Courts**

Neither laches nor the law of the case doctrine prevents review of a federal court's subject matter jurisdiction.

[20] **Bankruptcy**

Financial distress was not prerequisite for bankruptcy subject matter jurisdiction pursuant to Constitution; subject matter jurisdiction for bankruptcy extended to all cases filed under Bankruptcy Code. U.S. Const. art. 1, § 8, cl. 4.

[21] **Bankruptcy**

Bankruptcy jurisdiction extends at least to all cases where the law causes to be distributed the property of the debtor among his creditors, and its greatest limit is a discharge of the debtor from his contracts. U.S. Const. art. 1, § 8, cl. 4.

[22] **Bankruptcy**

All intermediate legislation, affecting substance and form of bankruptcy jurisdiction, but tending to further the great end of the subject—distribution and discharge—are in the competency and discretion of Congress. U.S. Const. art. 1, § 8, cl. 4.

[23] **Bankruptcy**

The "subject of Bankruptcies" is not, properly, anything less than the subject of the relations between an insolvent or non-paying or fraudulent debtor, and his creditors, extending to his and their relief. U.S. Const. art. 1, § 8, cl. 4.

[24] **Bankruptcy**

Restructuring of debtor-creditor relations is at core of federal bankruptcy power. U.S. Const. art. 1, § 8, cl. 4.

[25] **Bankruptcy**

Insolvency is not a prerequisite for bankruptcy subject matter jurisdiction. U.S. Const. art. 1, § 8, cl. 4.

[26] **Bankruptcy**

Financial distress is not a requirement for bankruptcy subject matter jurisdiction. U.S. Const. art. 1, § 8, cl. 4.

[27] **Bankruptcy**

The bankruptcy requirements for debtor eligibility are not jurisdictional. 11 U.S.C.A. § 109.

[28] **Bankruptcy**

Bankruptcy case may commence even if debtor is not eligible under particular chapter. 11 U.S.C.A. §§ 109, 301.

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ORDER DENYING THE MOTIONS TO DISMISS OF CLAIMANTS WILSON BUCKINGHAM AND ANGELIKA WEISS AND THE OFFICIAL COMMITTEE OF ASBESTOS CLAIMANTS

Laura T. Beyer, United States Bankruptcy Judge

***1** This matter comes before the court on the February 17, 2023 Motion to Dismiss of Claimants Wilson Buckingham and Angelika Weiss (Dkt. 2882 [1]) (the "Buckingham Motion") and the March 30, 2023 Official Committee of Asbestos Claimants' Motion to Dismiss for Lack of Subject Matter Jurisdiction (Dkt. 2925) (the "Committee's Motion") (collectively the "Motions to Dismiss"). The court concludes that it has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334, [2] venue is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409, and this is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). Having reviewed and considered the Motions to Dismiss, the joinders, responses, and replies thereto, and after considering the arguments of counsel at the hearings on March 15, 2023 and May 17, 2023 and having announced its ruling on the Motions to Dismiss at a hearing on July 28, 2023, the court further finds and concludes that it should deny the Motions to Dismiss for the reasons that follow.

Facts and Procedural History

1. Bestwall LLC (the "Debtor") filed a petition under Chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code") on November 2, 2017. The Debtor's pre-petition history was unusual and unusually brief. About three months prior to the petition date, the Debtor was created in a divisive merger corporate transaction pursuant to Texas state law that has come to be known as the "Texas Two-Step." See Debtor's Opposition to Third Motion to Dismiss Chapter 11 Case (Dkt. 2894) ("Debtor's Response to the Buckingham Motion") at 3 (noting corporate restructuring on July 31, 2017); Michael A. Francus, *Texas Two-Stepping Out of Bankruptcy*, 120 MICH. L. REV. ONLINE 38, 40 (2022) (explaining divisive mergers). The transaction divided the Debtor's predecessor, Georgia-Pacific LLC ("Old GP" prior to the transaction), into two new entities, the Debtor and a new version of Georgia-Pacific LLC ("New GP"). Informational Brief of Bestwall LLC (Dkt. 12) at 7–8. The divisive merger imbued the Debtor with Old GP's asbestos liability and certain assets including a "funding agreement" with New GP that "ensures that the Debtor has the same financial resources and ability to satisfy asbestos claims as Old GP had prior to the 2017 Corporate Restructuring," while New GP took all of Old GP's other assets and liabilities. [3] Id. at 8.

***2** 2. The Motions to Dismiss constitute the third and fourth motions to dismiss this bankruptcy case. On August 15, 2018, the Official Committee of Asbestos Claimants (the "Committee") filed a motion to dismiss this case as a bad faith filing pursuant to 11 U.S.C. § 1112(b) [4] or, alternatively, to transfer venue of the case to Delaware (Dkt. 495) (the "First Motion to Dismiss"). The court entered its Memorandum Opinion and Order Denying the Official Committee of Asbestos Claimants' Motion for Dismissal, or Alternatively, Venue Transfer (Dkt. 891) (the "Opinion and Order") on July 29, 2019. In re Bestwall LLC, 605 B.R. 43 (Bankr. W.D.N.C. 2019). In its Opinion and Order, the court summarizes the two-prong standard for dismissing a Chapter 11 case as a bad faith filing established by the United States Court of Appeals for the Fourth Circuit (the "Fourth Circuit") in the Carolin case, which requires a determination that the case is both (i) objectively futile and (ii) filed in subjective bad faith. Bestwall, 605 B.R. at 48 (citing Carolin Corp. v. Miller, 886 F.2d 693, 700–01 (4th Cir. 1989)). Among other things, the court determined that "[a]ttempting to resolve asbestos claims through 11 U.S.C. § 524(g) is a valid reorganizational purpose, and filing for Chapter 11, especially in the context of an asbestos or mass tort case, need not be due to insolvency." Id. at 49. The court also stated that "[t]he volume of current asbestos claims that Bestwall faced as of the Petition Date, coupled with the projected number of claims to be filed through 2050 and beyond, is sufficient financial distress for Bestwall to seek resolution under section 524(g) of the Bankruptcy Code" and that the asbestos-related claims could be "sufficiently addressed and fairly adjudicated through a section 524(g) trust." Id. at 49, 50. The court concluded that because Bestwall has the resources with which to reorganize, this case is not objectively futile, it need not reach the issue of whether the case was filed in subjective bad faith, and dismissal was not appropriate under the Fourth Circuit's stringent two-prong dismissal standard. Id. at 50–51.

3. On August 12, 2019, the Committee filed a notice of appeal (Dkt. 917) of the Opinion and Order, a motion for leave to appeal (Dkt. 918), and a request for certification of direct appeal to the Fourth Circuit (Dkt. 920). This court approved the request for the direct appeal on September 11, 2019 in its Certification for Direct Appeal to the United States Court of Appeals for the Fourth Circuit Under 28 U.S.C. § 158(d)(2) (Dkt. 987) ("Certification for Direct Appeal"), [5] and, in turn, the Committee filed its petition for direct appeal with the Fourth Circuit on October 11, 2019. On November 14, 2019, the Fourth Circuit denied the petition for direct appeal, and New GP opposed the Committee's motion for leave to appeal before the United States District Court for the Western District of North Carolina (the "District Court").

4. On February 3, 2023, the Committee filed a notice of supplemental authority (W.D.N.C. Dkt. 12 [6]) ("Committee's Notice") bringing to the attention of the District Court the "pertinent and significant new authority" of the opinion of the United States Court of Appeals for the Third Circuit in the LTL Management case (the "LTL Opinion"). Committee's Notice at 2; see LTL Mgmt., LLC v. Those Parties Listed on Appendix A to Complaint and John and Jane Does 1–1000 (In re LTL Mgmt., LLC), 64 F.4th 84 (3d Cir. 2023). Based on the LTL Opinion, the Committee urged the District Court to accept the pending notice of appeal (or grant the Committee's motion for leave to pursue an interlocutory appeal) so the Fourth Circuit would have a chance to consider the applicability of the Carolin standard to "a debtor that failed to exhibit financial distress prior to invoking the substantial protections of the Bankruptcy Code." Committee's Notice at 2. The Debtor responded (W.D.N.C. Dkt. 13) ("Debtor's Response to Committee's Notice") and asserted that nothing about the LTL Opinion changed the reasons why the District Court should "deny leave to appeal the interlocutory order denying the Committee's motion to dismiss Bestwall's bankruptcy case." Debtor's Response to Committee's Notice. The Debtor further opined that the LTL Opinion is based on a different standard and has no application to the appeal of the Opinion and Order. Id. at ¶ 3.

***3** 5. More recently in the District Court and based on the pleadings filed by the Committee in this case related to the Committee's Motion, the Debtor filed a motion for leave to file a statement regarding the Committee's change in position on the finality of the Opinion and Order (W.D.N.C. Dkt. 14) ("Debtor's Motion for Leave"). The Debtor points out that in support of the Committee's Motion in this court, the Committee argues that the Opinion and Order denying the First Motion to Dismiss is interlocutory contrary to its position in the District Court that the Opinion and Order is final and appealable as of right. Debtor's Motion for Leave. In addition, the Committee filed a second notice of supplemental authority (W.D.N.C. Dkt. 15) notifying the District Court of the recent decision of the United States Bankruptcy Court for the Southern District of Indiana dismissing Aearo's bankruptcy cases, which it argues supports the Committee's motion for leave to appeal the Opinion and Order. See In re Aearo Techs. LLC, Ch. 11 Case No. 22-02890, 2023 WL 3938436 (Bankr. S.D. Ind. June 9, 2023). Finally, the Debtor filed a notice of supplemental authority (W.D.N.C. Dkt. 17) ("Debtor's Notice") notifying the District Court of the Fourth Circuit's opinion in Bestwall LLC v. Off. Comm. of Asbestos Claimants (In re Bestwall LLC), 71 F.4th 168 (4th Cir. 2023). The Debtor argues that the Fourth Circuit's decision is relevant because it (1) confirmed that the two-pronged standard of Carolin remains the controlling law in this circuit for a motion to dismiss a Chapter 11 case as a bad faith filing; [7] (2) reinforced the bankruptcy court's finding that this case is not objectively futile; and (3) rejected the Committee's "attempt to attack the preliminary injunction 'as a back-door way to challenge the propriety of the reorganization and the merits of a yet-to-be-filed chapter 11 plan,' which was 'both premature and improper.' " Debtor's Notice at 1–2 (quoting Off. Comm. of Asbestos Claimants, 71 F.4th at 183). The Committee's appeal and motion for leave to appeal the Opinion and Order remained pending before the District Court at the time the court issued its ruling from the bench on the Motions to Dismiss on July 28, 2023. [8]

6. The Committee filed a second motion to dismiss (Dkt. 938) (the "Second Motion to Dismiss") on August 16, 2019,

arguing primarily that the case should be dismissed based on the Debtor's failure to prosecute this case. The Committee filed the Second Motion to Dismiss less than one month after the court entered the Opinion and Order, and the court entered an order (Dkt. 1546) on December 22, 2020 denying the Second Motion to Dismiss without prejudice. The court decided that the Debtor had not failed to prosecute the Chapter 11 case within the meaning of section 1112(b)(4) and that the Committee had not established cause to dismiss the case.

7. In the Committee's Motion (its third motion to dismiss this case), the Committee moves to dismiss this case for lack of constitutional subject matter jurisdiction. The Committee asserts that the Debtor is not an eligible subject of bankruptcy pursuant to the Bankruptcy Clause of the Constitution because it lacks sufficient financial distress. Committee's Motion at 2. According to the Committee, the Debtor is neither insolvent nor in need of bankruptcy for its survival and, therefore, does not qualify for bankruptcy relief. Id. The Committee insists that "Bestwall's economic health and ability to timely and fully pay all its creditors, including all present and future asbestos claimants, is (and was at the time of its bankruptcy filing) unthreatened. Neither financial nor operational requirements have necessitated bankruptcy restructuring, and Bestwall is therefore not an eligible 'subject of [B]ankrupt[y]' as that word was understood by the drafters of the Constitution and the delegates ratifying the Constitution." Id. The Committee contends that "a bankruptcy court must first determine whether the entity seeking debtor status meets the fundamental requirements of the Constitution" before considering statutory restrictions on debtors, including whether a bankruptcy case should be dismissed as a bad faith filing. Id. In other words, the Debtor must be in sufficient financial distress to be constitutionally eligible to seek protection under the Bankruptcy Code.

***4** 8. In support of its argument, the Committee cites findings of fact made by this court in its Opinion and Order and its July 29, 2019 Memorandum Opinion and Order Granting the Debtor's Request for Preliminary Injunctive Relief (A.P. Dkt. 164 [9]) in reliance on the Debtor's assertion that it is fully capable of paying all asbestos claims in full with the support of the funding agreement. Id. at 4. The Committee further relies on developments that have occurred since the filing of the case to demonstrate that Bestwall's financial wherewithal has grown stronger as this case has progressed. Id. at 4–5. Specifically, the Committee points to the facts that since the filing of the case, Bestwall has created and funded a $1 billion qualified settlement trust; New GP's equity value has increased by $7.1 billion to $27.8 billion; and New GP has upstreamed over $5 billion in dividends to its ultimate parent, Koch Industries. Id. at 5.

9. The Committee asserts that this motion to dismiss "is a new and distinct argument from any previously raised; [and] it also provides additional context for considering the proper scope and application of the Fourth Circuit's Carolin test," which it concedes was the focus of the First Motion to Dismiss. Id. at 7, 9. According to the Committee, in addition to lacking constitutional subject matter jurisdiction, the "Fourth Circuit's case law, regarding debtors whose bankruptcies were dismissed for bad faith, must be read, interpreted and applied within the constitutional limitations of bankruptcy jurisdiction." Id. at 20. The Committee says that consistent with the constitutional requirement of significant financial distress, "[t]he rationale behind Carolin ... suggests that real financial distress is, in effect, to be assumed or accepted before application of the Carolin test." Id. at 26.

10. This part of the Committee's argument is consistent with the Buckingham Motion. Mr. Buckingham argues this case must be dismissed because it does not meet the good-faith threshold established by the Fourth Circuit in Carolin, the Debtor is not eligible for bankruptcy relief because it is neither in financial distress nor facing "overwhelming liabilities," and it cannot confirm a § 524(g) plan of reorganization. Buckingham Motion at 7. The Buckingham Motion relies extensively on the Third Circuit's recent LTL Opinion dismissing the LTL Management case as a bad faith filing in urging the court to dismiss this case under 11 U.S.C. §§ 105 and 1112(b) for lack of good faith. [10] See id. at 3, 4, 6, 10, 12–13, 19, 20, 22–23, 26–27. Similar to the conclusion reached by the Third Circuit in the LTL Opinion, Mr. Buckingham argues that pursuant to Carolin, and as a threshold matter, the Debtor must demonstrate it is in sufficient financial distress due to overwhelming asbestos liability and that it has a limited fund that is insufficient to pay current and future claimants in order for its bankruptcy case to serve a legitimate bankruptcy purpose and to survive a motion to dismiss the case as a bad faith filing. Id. at 8, 15. Only once the Debtor has demonstrated sufficient financial distress should the court reach the question of the Debtor's ability to be rehabilitated. Id. at 8. And like the Committee's Motion, Mr. Buckingham relies on several events that have occurred since the filing of the case that he believes demonstrate the Debtor's lack of financial distress and the impropriety of the case, including the fact that New GP has distributed over $5 billion in dividends to Koch Industries and New GP's

substantial increase in equity value. Id. at 14–15, 17. Mr. Buckingham argues that the proper focus is not the number of asbestos claims pending against the Debtor but the Debtor's ability to pay those claims. Id. at 6. And the profitability of the Debtor since this case was filed—as evidenced by the dividends issued by New GP and the substantial increase in its equity—demonstrates the Debtor's clear ability to pay its current and future asbestos claims. Id. at 14–15. On this basis, Mr. Buckingham moves to have the court dismiss this case as a bad faith filing pursuant to Carolin.

***5** 11. In response, the Debtor contends that the court lacks jurisdiction to consider the Buckingham Motion because it seeks the same relief that was sought by the Committee in its First Motion to Dismiss on fundamentally the same grounds. Debtor's Response to the Buckingham Motion at 1, 17–25. The Debtor argues the court is divested of jurisdiction to consider the Buckingham Motion due to the Committee's appeal of the court's Opinion and Order denying the First Motion to Dismiss and its motion for leave to appeal. Id. at 5–8. In addition, the Debtor insists that Mr. Buckingham should be barred by the doctrine of laches from bringing his motion to dismiss given the length of time this case has been pending. The Debtor also argues that the Opinion and Order is law of the case and the court should deny the Buckingham Motion because it seeks to dismiss the case on the same grounds argued by the Committee in the First Motion to Dismiss. Id. at 8–11. Finally, the Debtor insists that even if the court were to consider the merits of the Buckingham Motion, it presents no new arguments that would cause the court to reach a different conclusion than when it denied the First Motion to Dismiss. Id. at 17–25.

12. Similarly, in its response to the Committee's Motion, the Debtor asserts that the doctrines of laches and law of the case bar the Committee's argument and that this court is divested of jurisdiction to consider the dismissal issues raised in the Committee's Motion because they are pending before the District Court on appeal. Debtor's Opposition to the Official Committee of Asbestos Claimants' Third Motion to Dismiss Chapter 11 Case (Dkt. 2973) at 2, 13–19. In response to the Committee's assertion that this court lacks subject matter jurisdiction, the Debtor insists that the court has jurisdiction and has properly exercised it in the six years this case has been pending. Id. at 2, 6–13. According to the Debtor, the question of eligibility to be a debtor is not a question of jurisdiction because bankruptcy courts have subject matter jurisdiction over all cases filed under the Bankruptcy Code. Id. at 7 (quoting In re Auto. Pros., Inc., 370 B.R. 161, 167 (Bankr. N.D. Ill. 2007)). Further, the Debtor argues that the Bankruptcy Clause of the United States Constitution does not impose an insolvency or financial distress requirement to be a debtor. Id. at 9.

Discussion

[1] 13. Mr. Buckingham seeks dismissal of this case under Carolin largely for the same reasons previously argued by the Committee in its First Motion to Dismiss and considered and decided by this court in its Opinion and Order. As demonstrated by the chart ("Debtor's Chart") attached as Exhibit A to the Debtor's Response to the Buckingham Motion, Mr. Buckingham and the Committee use similar language to argue that the court should dismiss this case as a bad faith filing and that the Debtor and/or New GP are not in financial distress.

[2] 14. Pursuant to the law of the case doctrine and in the interest of finality, "when a court decides upon a rule of law, that decision should continue to govern the same issues in subsequent stages in the same case." Carlson v. Bos. Sci. Corp., 856 F.3d 320, 325 (4th Cir. 2017) (quoting TFWS, Inc. v. Franchot, 572 F.3d 186, 191 (4th Cir. 2009)); see also Mar-Bow Value Partners, LLC v. McKinsey Recovery & Transformation Servs. U.S., LLC, 469 F. Supp. 3d 505, 524 (E.D. Va. 2020) ("[C]learly, courts could not perform their duties satisfactorily and efficiently if a question once considered and decided were to be litigated anew in the same case ...." (quoting Sejman v. Warner-Lambert Co., 845 F.2d 66, 68–69 (4th Cir. 1988))).

[3] 15. To determine the extent to which the law of the case governs, the court must first determine what issues it decided in the Opinion and Order and then decide whether any exceptions apply that might justify departing from the law of the case. See Mar-Bow, 469 F. Supp. 3d at 525. "The Fourth Circuit has recognized three exceptions to the law of the case doctrine: '(1) a subsequent trial produces substantially different evidence, (2) controlling authority has since made a contrary decision of law applicable to the issue, or (3) the prior decision was clearly erroneous and would work manifest injustice.' " Id. (quoting TFWS, 572 F.3d at 191). In addition, "the Supreme Court has advised that a 'court has the power to revisit prior decisions of its own or of a coordinate court in any circumstance, although as a rule courts should be loathe to do so in the absence of extraordinary circumstances ....' "

Id. (quoting Christianson v. Colt Indus. Operating Corp., 486 U.S. 800, 817, 108 S.Ct. 2166, 100 L.Ed.2d 811 (1988)).

***6** 16. As previously explained, the court concluded under Carolin in its Opinion and Order that this case is not objectively futile because Bestwall has the resources with which to reorganize, and, therefore, the court did not need to reach the issue of whether the case was filed in subjective bad faith and declined to dismiss this case under the Fourth Circuit's two-prong dismissal standard. Bestwall, 605 B.R. at 49–51. In reaching that conclusion, the court found that attempting to resolve asbestos claims through section 524(g) is a valid reorganizational purpose and that the volume of current asbestos claims coupled with the number of claims to be filed is sufficient financial distress for the Debtor to file this Chapter 11 case. Id. at 49.

17. In considering the exceptions to the law of the case doctrine, the court notes that Mr. Buckingham does not cite to substantially different evidence (or any evidence produced in a subsequent trial) sufficient to cause this court to revisit the Opinion and Order. Rather, he relies on the comments of Bestwall's counsel at a meeting of the American Bankruptcy Institute, Buckingham Motion at 4, 5, 17, 20, 21, that largely appear to have been taken out of context and are not inconsistent (when read in context) with statements Debtor's counsel has made on the record to this court. Mr. Buckingham focuses on the dividends issued by Georgia-Pacific post-petition, id. at 5, 6, 14–15, 16–17, 27, that have been disclosed throughout this case and are consistent with corporate practice predating this case, see Stipulation Regarding Postpetition Dividends Paid by Non-Debtor Georgia-Pacific LLC (Dkt. 997); Declaration of Tyler L. Woolson (Dkt. 998); Second Stipulation Regarding Postpetition Dividends Paid by Non-Debtor Georgia-Pacific LLC (Dkt. 2346); Declaration of Tyler L. Woolson (Dkt. 2347); Declaration of Julie A. Anderson (Dkt. 2857). Additionally, the Debtor's rejection of the Committee's plan does not serve as a basis for this court to reconsider the Opinion and Order. At a prior hearing in this case, the court noted that the Committee's plan is "akin to dismissal" and would need to be modified to be confirmable. See Oct. 22, 2020 Hr'g Tr. 16:22–24; 17:22–23.

[4] 18. Mr. Buckingham points to the Fourth Circuit's recently-issued opinion in the Kaiser case as new law issued by controlling authority that is applicable to the issue of whether the court should dismiss this case under Carolin. Buckingham Motion at 2, 6, 11 (citing In re Kaiser Gypsum Co., 60 F.4th 73 (4th Cir. 2023)). According to Mr. Buckingham, in Kaiser "the Fourth Circuit Court of Appeals reiterated the purpose of Chapter 11 generally and of Section 524(g) specifically: it is for (a) financially distressed debtors, (b) faced with overwhelming asbestos liabilities, to (c) create a trust that marshals limited and inadequate assets so that present and future claimants share equitably—providing all with a better outcome than a forced liquidation." Buckingham Motion at 2 (emphasis omitted) (citing Kaiser, 60 F.4th at 77–78). Mr. Buckingham, however, misconstrues the discussion of section 524(g), which is in two introductory paragraphs of an opinion that addresses an insurer's standing to object to a Chapter 11 plan. Financial distress was not at issue in Kaiser, and the cited portion of Kaiser actually confirms that "§ 524(g) of the Bankruptcy Code allows a Chapter 11 debtor with **substantial asbestos liabilities** to obtain a channeling injunction that diverts all asbestos claims, current and future, to a trust established by the debtor's reorganization plan and funded by the debtor," Kaiser, 60 F.4th at 77–78 (emphasis added), which is not inconsistent with the conclusion reached by this court in its Opinion and Order.

***7** 19. Mr. Buckingham also relies heavily on the Third Circuit's recent LTL Opinion as mandating the dismissal of this case. See *supra* ¶ 10. That opinion, however, is neither controlling nor applicable to this matter. Indeed, the Third Circuit recognizes in the LTL Opinion that "[i]n the Fourth Circuit, a court can only dismiss a bankruptcy petition for lack of good faith on a showing of the debtor's 'subjective bad faith' and the 'objective futility of any possible reorganization.' " LTL, 64 F.4th at 98 n.8 (quoting Carolin, 886 F.2d at 694). The Third Circuit also acknowledges the reference by the bankruptcy court below to the Fourth Circuit's dismissal standard as a "much more stringent standard for dismissal of a case for lacking good faith" than the standard in the Third Circuit, but it did not analyze—nor should it have—whether this case should be dismissed pursuant to that standard. Id. (quoting In re LTL Mgmt., LLC., 637 B.R. 396, 406 (Bankr. D.N.J. 2022)).

20. In sum, the Buckingham Motion seeks to have this court reconsider its earlier ruling in the Opinion and Order. Counsel for Mr. Buckingham insists to the contrary and at the hearing on the Buckingham Motion, he argued that the First Motion to Dismiss "was a different focus at a different time on different facts by a different party." March 15, 2023 Hr'g Tr. 19:12–13. While the movant is different and the motion was filed four and a half years after the First Motion to Dismiss, the focus is on substantially the same facts, some new facts that the court does not consider to be substantially different evidence, and

some new law that is either not controlling or is consistent with the court's Opinion and Order. And the ultimate question remains exactly the same: should the court dismiss this case as a bad faith filing under Carolin? Neither the new facts cited by Mr. Buckingham nor the new law issued since the court entered its Opinion and Order cause this court to conclude that its earlier decision to deny the First Motion to Dismiss was either erroneous or works a manifest injustice, extraordinary circumstances do not exist which cause this court to revisit its earlier decision, and the court concludes that the Opinion and Order continues to be the law of this case.

[5] **[6]** **[7]** 21. In addition to concluding that the Opinion and Order is the law of this case and should not be reconsidered, the court also thinks that its jurisdiction to do so is questionable given the pending appeal of the Opinion and Order. Generally, the timely filing of a notice of appeal "confers jurisdiction on the court of appeals and divests the district court [11] of its control over those aspects of the case involved in the appeal." Levin v. Alms & Assocs., Inc., 634 F.3d 260, 263 (4th Cir. 2011) (quoting Griggs v. Provident Consumer Disc. Co., 459 U.S. 56, 58, 103 S.Ct. 400, 74 L.Ed.2d 225 (1982)). For the same reasons, "[a] bankruptcy court is divested of jurisdiction with respect to matters raised in an appeal to a higher court." In re Bryant, 175 B.R. 9, 13 (W.D. Va. 1994) (citing In re Bialac, 694 F.2d 625, 627 (9th Cir. 1982)). "The purpose of the general rule is to avoid the confusion of placing the same matter before two courts at the same time and [to] preserve the integrity of the appeal process." In re Whispering Pines Ests., Inc., 369 B.R. 752, 757 (B.A.P. 1st Cir. 2007) (citations omitted); see also Doe v. Pub. Citizen, 749 F.3d 246, 258 (4th Cir. 2014) (The divesting rule "fosters judicial economy and guards against the confusion and inefficiency that would result if two courts simultaneously were considering the same issues.").

***8** **[8]** **[9]** 22. The court is attuned to the fact that bankruptcy cases often raise multiple issues, many of which are entirely unrelated to issues involved in an appeal. For that reason, "[t]he application of a broad rule that a bankruptcy court may not consider any request filed while an appeal is pending has the potential to severely hamper a bankruptcy court's ability to administer its cases in a timely manner." Whispering Pines, 369 B.R. at 758 (citations omitted). And courts recognize that "when a notice of appeal has been filed in a bankruptcy case, the bankruptcy court retains jurisdiction to address elements of the bankruptcy proceeding that are not the subject of that appeal." In re Scopac, 624 F.3d 274, 280 (5th Cir. 2010) (quoting In re Transtexas Gas Corp., 303 F.3d 571, 580 (5th Cir. 2002)). The end result is a functional test: "once an appeal is pending, it is imperative that a lower court not exercise jurisdiction over those issues which, although not themselves expressly on appeal, nevertheless so impact the appeal so as to interfere with or effectively circumvent the appeal process." Id. (quoting Whispering Pines, 369 B.R. at 759).

23. That is the situation here given the similarity between the issues raised in the Buckingham Motion and those on appeal in the District Court. For this court to exercise jurisdiction over the issues raised in the Buckingham Motion could unnecessarily interfere with or confuse the appeal process. For the same reasons previously explained, the Buckingham Motion is an attempt to have the court reconsider its Opinion and Order, and the issues raised in the motion are closely related to the issues on appeal in the District Court. The Buckingham Motion seeks dismissal of this case for "cause" under section 1112(b) as a bad faith filing for many of the same reasons previously argued by the Committee in its First Motion to Dismiss and considered and decided by this court in its Opinion and Order denying that motion. See Debtor's Chart (comparing arguments from the First Motion to Dismiss and the Buckingham Motion). Mr. Buckingham asks this court to bring "fresh eyes" and "hindsight" to its prior ruling and disputes the Debtor's earlier arguments against dismissal. Buckingham Motion at 4–5. By way of further example, the Buckingham Motion cites the LTL Opinion in arguing that financial distress is a threshold requirement when considering a debtor's good faith in seeking the benefits of a bankruptcy filing. See *supra* ¶ 10. Similarly, the Committee filed a notice of supplemental authority to bring the LTL Opinion to the attention of the District Court and relies on it as a basis for the District Court to accept the appeal of the Opinion and Order so the Fourth Circuit can consider "the applicability of the Carolin standard [to] a debtor that failed to exhibit financial distress prior to invoking the substantial protections of the Bankruptcy Code." Committee's Notice at 2. Both the Committee and Mr. Buckingham argue that this case lacks a valid bankruptcy purpose, manipulates the Bankruptcy Code and bankruptcy jurisdiction, and deprives victims of jury trial rights. See, e.g., First Motion to Dismiss at 15–18, Committee's reply in support of First Motion to Dismiss (Dkt. 653) at 13, Buckingham Motion at 4, 7. Finally, the crux of both motions is a determination of whether this case should be dismissed under Carolin as a bad faith filing. In short, the issues raised in the Buckingham Motion are closely related to the matter on appeal and consideration of the merits of the Buckingham Motion could "so impact the appeal ... as to

interfere with or effectively circumvent the appeal process." Scopac, 624 F.3d at 280 (quoting Whispering Pines, 369 B.R. at 759).

[10] 24. There is an exception to the divestment rule if the appeal is interlocutory. See BAE Sys. Tech. Sol. & Servs., Inc. v. Republic of Korea, No. 14-3551, 2016 WL 6167914, at *3 (D. Md. Oct. 24, 2016) ("Interlocutory appeals do not divest [lower] courts of jurisdiction." (citing Columbus-Am. Discovery Grp. v. Atl. Mut. Ins. Co., 203 F.3d 291, 302 (4th Cir. 2000))). The determination of whether the Opinion and Order is interlocutory, however, is also pending in the District Court. As Bryant recognized, "it is not for this court to determine ultimately whether its order is properly appealable such that jurisdiction has vested in the appellate court." 175 B.R. at 12–13. To rule on that issue and to reconsider the court's earlier ruling on the First Motion to Dismiss while the appeal remains pending could moot the appeal, lead to inconsistent results, or prompt a second appeal. Undoubtedly, it would unnecessarily muddy the waters. For those reasons, the court will decline to consider the merits of the issues raised in the Buckingham Motion. [12]

***9** **[11]** 25. With respect to the arguments the Committee makes regarding Carolin by extension of its subject matter jurisdiction argument, the court will decline to reconsider its earlier rulings in the Opinion and Order for the same reasons it is declining to consider the Buckingham Motion on the merits. Issues of subject matter jurisdiction, however, "may be resurrected at any point in the litigation." Gonzalez v. Thaler, 565 U.S. 134, 141, 132 S.Ct. 641, 181 L.Ed.2d 619 (2012); see also Ashcroft v. Iqbal, 556 U.S. 662, 671, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) ("Subject-matter jurisdiction cannot be forfeited or waived and should be considered when fairly in doubt." (citing Arbaugh v. Y & H Corp., 546 U.S. 500, 514, 126 S.Ct. 1235, 163 L.Ed.2d 1097 (2006))); Educ. Credit Mgmt. Corp. v. Kirkland (In re Kirkland), 600 F.3d 310, 315 (4th Cir. 2010) ("[S]ubject matter jurisdiction may be questioned at any stage of litigation, including an appeal."); In re Aldrich Pump LLC, Ch. 11 Case No. 20-30608, 2023 WL 9016506, at *9 (Bankr. W.D.N.C. Dec. 28, 2023) ("Lack of subject matter jurisdiction can be asserted at any time." (citations omitted)). Because the absence of subject matter jurisdiction may be raised at any time, the court will consider that aspect of the Committee's Motion.

[12] **[13]** **[14]** **[15]** **[16]** 26. This court and all federal courts have limited jurisdiction and can only exercise the power authorized by the Constitution and Congress. Kokkonen v. Guardian Life Ins. Co. of Am., 511 U.S. 375, 377, 114 S.Ct. 1673, 128 L.Ed.2d 391 (1994); Owen Equip. & Erection Co. v. Kroger, 437 U.S. 365, 374, 98 S.Ct. 2396, 57 L.Ed.2d 274 (1978). Subject matter jurisdiction sets the outer limit of a court's authority, and nonjurisdictional rules control within the jurisdictional boundaries. Santos-Zacaria v. Garland, 598 U.S. 411, 416, 143 S.Ct. 1103, 215 L.Ed.2d 375 (2023) (citations omitted). The Bankruptcy Clause of the Constitution determines the limits of constitutional subject matter jurisdiction for bankruptcy. See Wright v. Union Cent. Life Ins. Co., 304 U.S. 502, 513, 58 S.Ct. 1025, 82 L.Ed. 1490 (1938) (providing that the right of Congress to legislate on bankruptcy is in general terms and quoting the Bankruptcy Clause); Schumacher v. Beeler, 293 U.S. 367, 374, 55 S.Ct. 230, 79 L.Ed. 433 (1934) ("The Congress, by virtue of its constitutional authority over bankruptcies (Const. Art. 1, § 8), could confer or withhold jurisdiction to entertain such suits and could prescribe the conditions upon which the federal courts should have jurisdiction."); Ralph Brubaker, *On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory*, 41 WM. & MARY L. REV. 743, 807 (2000) [hereinafter *Federal Bankruptcy Jurisdiction*] (noting that most Supreme Court discussions of bankruptcy jurisdiction rely on the Bankruptcy Clause); William E. Mussman & Stefan A. Riesenfeld, *Jurisdiction in Bankruptcy*, 13 LAW & CONTEMP. PROBS. 88, 89 (1948) (reading the scope of the Bankruptcy Clause with Article III as allowing all bankruptcy jurisdiction in federal court). But see Aldrich, 2023 WL 9016506, at *13 ("[C]onstitutional challenges which are not targeted at the scope of Article III are not challenges to the Court's subject matter jurisdiction."). [13] Congress determines subject matter jurisdiction within any limitations imposed by the Constitution. United States v. Denedo, 556 U.S. 904, 912, 129 S.Ct. 2213, 173 L.Ed.2d 1235 (2009). The party advocating in favor of a court's subject matter jurisdiction over a particular case or issue bears the burden of proof. Demetres v. E. W. Constr., Inc., 776 F.3d 271, 272 (4th Cir. 2015); Piney Run Pres. Ass'n v. Cnty. Comm'rs, 523 F.3d 453, 459 (4th Cir. 2008); Glaspell v. United States (In re Glaspell), Ch. 7 Case No. 17-bk-00301, Adv. No. 19-ap-36, 2020 WL 4577479, at *2 (Bankr. N.D. W. Va. Aug. 7, 2020).

[17] **[18]** **[19]** 27. Since subject matter jurisdiction can be raised at any time and is a requirement for courts to exercise their power, it cannot be defeated by equitable defenses. See Gonzalez, 565 U.S. at 141, 132 S.Ct. 641 ("Subject-matter jurisdiction can never be waived or forfeited."); cf. Valley Historic Ltd. P'ship v. Bank of N.Y., 486 F.3d 831, 838 (4th

Cir. 2007) (deciding even res judicata does not overcome a bankruptcy court's obligation to determine its subject matter jurisdiction). The concepts of consent, waiver, and estoppel do not apply to subject matter jurisdiction because it is created and limited by the Constitution and statutes. Constantine v. Rectors & Visitors of George Mason Univ., 411 F.3d 474, 480 (4th Cir. 2005); see MOAC Mall Holdings LLC v. Transform Holdco LLC, 598 U.S. 288, 298, 143 S.Ct. 927, 215 L.Ed.2d 262 (2023) ("[N]ot even such egregious conduct by a litigant could permit the application of judicial estoppel as against a jurisdictional rule."). Similarly, neither laches nor the law of the case doctrine [14] prevents review of subject matter jurisdiction. Hager v. Gibson, 188 B.R. 194, 196 (E.D. Va. 1995) (laches); Aldrich, 2023 WL 9016506, at *9 (laches); Am. Canoe Ass'n, Inc. v. Murphy Farms, Inc., 326 F.3d 505, 515–16 (4th Cir. 2003) (law of the case).

***10** **[20]** 28. Since the equitable defenses proffered by the Debtor are insufficient to defeat a motion challenging subject matter jurisdiction, the court will consider the Committee's Motion on the merits. The Committee's nuanced argument is that the court does not have constitutional subject matter jurisdiction to hear this case due to the Debtor's lack of financial distress. [15] See *supra* ¶ 7. Put another way, the Committee contends that the language of the Bankruptcy Clause implicitly disqualifies entities that are not suffering financial distress from invoking the subject matter jurisdiction of this court. Since there is no subject matter jurisdiction, according to the Committee, this case is void and must be dismissed.

29. Accordingly, the court must look to the language of the Bankruptcy Clause and its meaning in order to determine whether there is subject matter jurisdiction for this case. The Bankruptcy Clause is found at Article I, Section 8, Clause 4 of the Constitution and provides, in its entirety, that "Congress shall have Power ... To establish ... uniform Laws on the subject of Bankruptcies throughout the United States." The limited constitutional guidance on the breadth of the bankruptcy power does not explicitly require debtors to suffer from any level of financial distress. In fact, the Bankruptcy Clause does not provide any guidance at all about what types of entities are constitutionally eligible for bankruptcy protection. The Committee, however, contends that the Debtor exceeds the constitutional grant of jurisdiction because it is not a proper "subject of Bankruptcies" due to its lack of financial distress. See Committee's Motion at 2. In other words, according to the Committee, Congress could not make any "uniform Laws on the subject of Bankruptcies" applicable to this Debtor. In a way, and contrary to more typical challenges to subject matter jurisdiction, the Committee is not challenging a law about subject matter jurisdiction but the absence thereof, contending that Congress failed to include a necessary condition, financial distress, in its statutory grant of jurisdiction to the bankruptcy court.

30. Since the language of the Bankruptcy Clause does not address the meaning of "the subject of Bankruptcies," the court looks to the meaning of the clause at the time of adoption and as interpreted by courts since then. Bankruptcy and insolvency law [16] as practiced in 1787 in England and the United States (pre-Constitution) undoubtably influenced the Framers of the Bankruptcy Clause. See Cent. Va. Cmty. Coll. v. Katz, 546 U.S. 356, 362, 126 S.Ct. 990, 163 L.Ed.2d 945 (2006) ("It is appropriate to presume that the Framers of the Constitution were familiar with the contemporary legal context when they adopted the Bankruptcy Clause ...."). English law bore some similarities with modern bankruptcy law, but the modern bankruptcy practitioner would probably be more struck by the differences. See Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 499–503 (1996) [hereinafter "*Constitutional Limits*"] (discussing similarities and differences). Eighteenth-century English bankruptcy was exclusively for the benefit of creditors, and the system was strictly involuntary. Cont'l Ill. Nat'l Bank & Tr. Co. of Chi. v. Chi., Rock Island & Pac. Ry. Co., 294 U.S. 648, 668, 55 S.Ct. 595, 79 L.Ed. 1110 (1935). But see *Constitutional Limits*, *supra*, at 496 n.33 & 510 (arguing that English bankruptcy was only technically limited to involuntary petitions because friendly creditors frequently commenced cases). The concept of the discharge of debts was not introduced until 1705 (along with the death penalty for fraudulent debtors), and Parliament conditioned discharge on the consent of 80% of the creditor body (in number and amount of debt) the following year. *Constitutional Limits*, *supra*, at 500, 505–06. In addition, only businessmen ("traders") could be debtors in England at the time. [17] Hanover Nat'l Bank of the City of N.Y. v. Moyses, 186 U.S. 181, 184–85, 22 S.Ct. 857, 46 L.Ed. 1113 (1902). Despite these fundamental differences, some aspects of 18th century English bankruptcy law, such as the use of the predecessors of trustees, meetings of creditors, and proofs of claims, would be recognizable to a modern bankruptcy practitioner. *Constitutional Limits*, *supra*, at 500–01. Perhaps most importantly for this court's present purposes, 18th century English bankruptcy law did not require insolvency. [18] In re Klein, 14 F. Cas. 716, 717 (C.C.D.

Mo. 1843) ("By the English law, ... it mattered not whether the defendant was insolvent or otherwise ...."); Thomas E. Plank, *Bankruptcy and Federalism*, 71 FORDHAM L. REV. 1063, 1094 (2002) [hereinafter *Bankruptcy and Federalism*] (noting that insolvency was not always required by 18 th century laws). But see *Bankruptcy and Federalism*, *supra*, at 1094 (arguing that "acts of bankruptcy" and other jurisdictional requirements represented "more particular examples of insolvency").

***11** 31. Some American colonies and states got an early start on federalism, embraced the idea of the states as the laboratories of democracy, see New State Ice Co. v. Liebmann, 285 U.S. 262, 311, 52 S.Ct. 371, 76 L.Ed. 747 (1932) ("It is one of the happy incidents of the federal system that a single courageous state may, if its citizens chose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."), and experimented more with their bankruptcy systems. *Bankruptcy and Federalism*, *supra*, at 1085. Unlike English law, certain jurisdictions allowed voluntary proceedings, non-consensual discharge of debts, and non-trader debtors. Klein, 14 F. Cas. at 717; *Bankruptcy and Federalism*, *supra*, at 1085–87.

32. Against this backdrop, the Framers of the Constitution met in Philadelphia and adopted, among other provisions, the Bankruptcy Clause. Unfortunately for courts trying to divine its meaning 250 years later, the Framers did not give us much with which to work. See *Constitutional Limits*, *supra*, at 527 (noting that "[t]he proceedings of the Constitutional Convention shed little light" on the intent of the Bankruptcy Clause). The only vote against the Bankruptcy Clause came from a member of the Connecticut delegation who feared giving Congress the power to institute the death penalty as a punishment for bankruptcy. Katz, 546 U.S. at 369, 126 S.Ct. 990 (citation omitted); Ry. Lab. Execs.' Ass'n v. Gibbons, 455 U.S. 457, 472 & n.13, 102 S.Ct. 1169, 71 L.Ed.2d 335 (1982) (citation omitted). In the only meaningful, if brief, discussion of bankruptcy in *The Federalist*, James Madison emphasized the close relationship between bankruptcy and commerce as proof of the importance of uniform bankruptcy laws. Gibbons, 455 U.S. at 465–66, 102 S.Ct. 1169 ("As James Madison observed, '[t]he power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question.' " (alteration in original) (quoting THE FEDERALIST No. 42 at 285 (N.Y. Heritage Press 1945))). There is no direct evidence about whether the Framers intended to enshrine English bankruptcy law into the Constitution or had a more general concept of bankruptcy in mind. *Constitutional Limits*, *supra*, at 527. Likewise, there is no direct evidence that the Framers intended to require financial distress for bankruptcy jurisdiction.

33. It is difficult to discern exactly what the Framers had in mind for bankruptcy law, and subsequent developments (and the Supreme Court opinions allowing them) suggest that the Framers' intent was not of utmost importance, as the Framers could not have foreseen the ways that American bankruptcy would change (and be allowed to change). The liberalization of bankruptcy law, however, did not start immediately. The first several Congresses attempted but failed to pass a bankruptcy law until the first bankruptcy act passed in 1800. Katz, 546 U.S. at 373, 126 S.Ct. 990 (quoting C. WARREN, BANKRUPTCY IN UNITED STATES HISTORY 10 (1935)). The 1800 law was a copy of the familiar English law. Id.; *Constitutional Limits*, *supra*, at 499 & 533. But see Cont'l Ill., 294 U.S. at 670, 55 S.Ct. 595 (claiming the first American bankruptcy law "ignored" English law by expanding the reach beyond traders). [19]

34. More fundamental changes to the American bankruptcy system followed. The 1841 Act took a "radical step forward" by introducing voluntary petitions. Cont'l Ill., 294 U.S. at 670, 55 S.Ct. 595; see also In re Marshall, 300 B.R. 507, 516, 520 (Bankr. C.D. Cal. 2003) (noting that the 1841 Act was the first American bankruptcy law that allowed voluntary petitions), *aff'd*, 403 B.R. 668 (C.D. Cal. 2009), *aff'd*, 721 F.3d 1032 (9th Cir. 2013). [20] Previous bankruptcy regimes were intended to benefit creditors and viewed debtors as dishonest, but the 1841 law began the assumption of the honest but unfortunate debtor. Cont'l Ill., 294 U.S. at 670–71, 55 S.Ct. 595 (quoting Loc. Loan Co. v. Hunt, 292 U.S. 234, 244, 54 S.Ct. 695, 78 L.Ed. 1230 (1934)). Justice Catron, sitting as a circuit judge, reversed a district court ruling that the Bankruptcy Clause only allowed the 1787 English version of bankruptcy. Klein, 14 F. Cas. at 716, 719.

***12** 35. Insolvency was never a requirement for English or early American involuntary cases, which instead required "acts of bankruptcy." Marshall, 300 B.R. at 517–18. The 1841 Act did include a requirement for voluntary debtors to plead an inability to pay their debts, but it "was only a pleading requirement" as "[n]either the parties nor the court had the authority to inquire into whether a debtor was in fact insolvent." Id. at 516 (citing Ex parte Hull, 12 F. Cas. 853, 856 (S.D.N.Y. 1842)). This insolvency pleading requirement carried over into the 1867 Act but "disappeared entirely in 1878 (the date of repeal of the 1867 Act)" and did not reappear for voluntary cases in subsequent bankruptcy laws. Id. at 517.

36. The 1867 Act also continued the expansion of (or at least change in) American bankruptcy law from its English roots. A creditor challenged a provision of the 1867 Act allowing discharge on the partial payment of debt as not part of "the subject of Bankruptcies" as intended by the Bankruptcy Clause. In re Reiman, 20 F. Cas. 490, 492–93 (S.D.N.Y. 1874). A future Supreme Court justice, then-Judge Blatchford, catalogued the differences between bankruptcy as practiced in England and the United States and held that "[i]t cannot be doubted, that [C]ongress, in passing laws on the subject of bankruptcies, is not restricted to laws with such scope only as the English bankruptcy laws had when the [C]onstitution was adopted." Id. at 495–96; see also *Constitutional Limits*, *supra*, at 539–40 (summarizing Reiman and noting Judge Blatchford's subsequent Supreme Court position).

37. Congress enacted the first permanent American bankruptcy law in 1898. *Constitutional Limits*, *supra*, at 540. Among other innovations, the 1898 Act removed the need for creditors to consent to the debtor's discharge. Id. The Supreme Court faced a creditor's complaint that the 1898 Act violated the Bankruptcy Clause due to a lack of uniformity, the delegation of legislative power to the states, allowing non-trader debtors, and permitting voluntary petitions. Moyses, 186 U.S. at 183–84, 22 S.Ct. 857. The new law, however, "easily withstood challenges to its constitutionality as within the 'subject of Bankruptcies.' " *Constitutional Limits*, *supra*, at 540–41 (citing Moyses, 186 U.S. at 187, 22 S.Ct. 857).

38. Congress further expanded the 1898 Act in 1933 by adding reorganization provisions for individuals, farmers, and railroads. Id. at 541. Both the Supreme Court and the Fourth Circuit endorsed the expansion. See Cont'l Ill., 294 U.S. at 671, 55 S.Ct. 595 ("[T]hese acts, far-reaching though they be, have not gone beyond the limit of congressional power; but rather have constituted extensions into a field whose boundaries may not yet be fully revealed."); Campbell v. Alleghany Corp., 75 F.2d 947, 951 (4th Cir. 1935) ("[W]e entertain no doubt as to the constitutionality of the statute."). The Supreme Court concluded that the "fundamental and radically progressive ... extensions" were within Congress's bankruptcy power and showed the ability of the Bankruptcy Clause to address changes in business and social interactions, Cont'l Ill., 294 U.S. at 671, 55 S.Ct. 595, while the Fourth Circuit noted that Congress was addressing the shortfalls of prior bankruptcy laws, Campbell, 75 F.2d at 951.

39. Congress overhauled the 1898 Act by adopting our current bankruptcy law, the Bankruptcy Code, in 1978. Frank R. Kennedy, *The Commencement of a Case Under the New Bankruptcy Code*, 36 WASH. & LEE L. REV. 977, 981 (1979). Congress sought the recommendations of a Commission on Bankruptcy Laws of the United States, id. at 977–78, and, among other things, the Commission recognized the potential for a delay in filing a bankruptcy case to doom a reorganization before it even started and sought to remove barriers to voluntary petitions, REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, pt. 1, at 75 (1973) [hereinafter "REPORT"]. Accordingly, the Code provides for a "liberalization of access" by making the "order for relief"[21] "equivalent to adjudication under the Bankruptcy Act and ... tantamount to an order approving the court's exercise of jurisdiction" and requiring "[n]either insolvency nor inability to pay debts nor even the fact that the debtor is indebted in any amount ... to be alleged or proved" in voluntary petitions. Kennedy, *supra*, at 983–84 (footnote omitted); see also *Constitutional Limits*, *supra*, at 496 (noting that, other than a few exceptions, "there is no requirement of insolvency in any sense" to commence voluntary cases under the Bankruptcy Code).

***13** 40. This brief overview of the history of American bankruptcy law shows great change and innovation since the adoption of the Bankruptcy Clause, and the Supreme Court has described the clause in terms that suggest Congress has nearly unlimited power to determine the proper "subject of Bankruptcies." The Court has repeatedly emphasized that the "subject of Bankruptcies" is not limited to the English and/or early state version of bankruptcy in 1787. Wright, 304 U.S. at 513, 58 S.Ct. 1025 (citing Adair v. Bank of Am. Nat'l Tr. & Sav. Ass'n, 303 U.S. 350, 354, 58 S.Ct. 594, 82 L.Ed. 889 (1938); Cont'l Ill., 294 U.S. at 668, 55 S.Ct. 595); Cont'l Ill., 294 U.S. at 668, 55 S.Ct. 595 (remarking that the idea that the Framers intended to limit Congress to English law had been long-dispelled (in 1935)); Moyses, 186 U.S. at 187, 22 S.Ct. 857 (observing that the Framers were aware of Blackstone[22] and English law but granted power over the entire subject of bankruptcies without limitation); see also Bradford v. Fahey, 76 F.2d 628, 632 (4th Cir. 1935) ("It is clear that the power of Congress over bankruptcies is not limited by the terms of the

British and colonial statutes as they existed at the time of the adoption of the Constitution.").

41. If the language of the Bankruptcy Clause does not require bankruptcy as practiced in 1787, what exactly does it mean? The Supreme Court has resisted giving us a precise definition and has even asserted, as recently as 2022, that the scope of the Bankruptcy Clause cannot be fully defined. Siegel v. Fitzgerald, 596 U.S. 464, 473, 142 S.Ct. 1770, 213 L.Ed.2d 39 (2022) ("[T]he 'subject of bankruptcies is incapable of final definition ....' " (quoting Wright, 304 U.S. at 513, 58 S.Ct. 1025)); see also Moyses, 186 U.S. at 186, 22 S.Ct. 857 ("In considering the question before me, I have not pretended to give a definition (but purposely avoided any attempt to define) the mere word 'bankruptcy.' " (quoting Klein, 14 F. Cas. at 718)); *Federal Bankruptcy Jurisdiction*, *supra*, at 747 ("[B]ankruptcy has become the seemingly inscrutable crucible of federal jurisdiction theory."). Similarly, the Supreme Court has said there are some limits to Congress's power pursuant to the Bankruptcy Clause, but the limits are also beyond definition. Cont'l Ill., 294 U.S. at 669–70, 55 S.Ct. 595 ("Those limitations have never been explicitly defined, and any attempt to do so now would result in little more than a paraphrase of the language of the Constitution without advancing far toward its full meaning."). Given its inability to define the contours of the bankruptcy power, it is not surprising that the Court treats bankruptcy jurisdiction as unusual and unique. See, e.g., Allen v. Cooper, 589 U.S. 248, 140 S. Ct. 994, 1002, 206 L.Ed.2d 291 (2020) (noting that Katz reflects "what might be called bankruptcy exceptionalism" and distinguishing Katz based on the " 'singular nature' of bankruptcy jurisdiction" (quoting Katz, 546 U.S. at 369 n.9, 126 S.Ct. 990)).

42. The Supreme Court has, however, attempted to describe elements of the undefinable bankruptcy power. For example, the "Court has repeatedly emphasized that the Bankruptcy Clause's language, embracing 'laws on the subject of Bankruptcies,' is broad." Siegel, 596 U.S. at 473, 142 S.Ct. 1770; see also Charles J. Tabb, *The Bankruptcy Clause, the Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy*, 2015 No. 2 UNIV. ILL. L. REV. 765, 766 ("[T]he scope of congressional power ... is exceedingly broad."), 778 ("Justice Catron's *extraordinarily broad* definition of the scope of congressional power under the Bankruptcy Clause [in Klein] has been quoted in numerous cases with approval by the Supreme Court ...." (emphasis added)). In fact, the scope is so broad that it includes concepts that do not fit neatly into any possible definition. See, e.g., Wright, 304 U.S. at 514, 58 S.Ct. 1025 (observing that the purchase of a debtor's property by a third party is not part of the debtor-creditor relationship but "does enter into the radius of the bankruptcy power over debts"); *Bankruptcy and Federalism*, *supra*, at 1100–1104 (describing a few sections of the Bankruptcy Code, including 11 U.S.C. § 363(h), that violate "the Non-Expropriation Principle" by subordinating the property interests of third parties to the interests of creditors).

***14** 43. Congress's bankruptcy power is not just broad; it is also potent. Courts and commentators are especially fond of describing the power as "plenary"[23] and use similar terms that suggest that Congress's power in this field approaches omnipotence. Siegel, 596 U.S. at 474, 142 S.Ct. 1770 ("plenary" (quoting Moyses, 186 U.S. at 187, 22 S.Ct. 857)); Int'l Shoe Co. v. Pinkus, 278 U.S. 261, 265, 49 S.Ct. 108, 73 L.Ed. 318 (1929) ("unrestricted and paramount"); Campbell, 75 F.2d at 955 ("plenary"); Reiman, 20 F. Cas. at 496 ("general, unlimited and unrestricted"); Ralph Brubaker, *Explaining* Katz*'s New Bankruptcy Exception to State Sovereign Immunity: The Bankruptcy Power as a Federal Forum Power*, 15 ABI L. REV. 95, 131 (2007) ("practically unlimited"); *Federal Bankruptcy Jurisdiction*, *supra*, at 746 ("Congress, of course, has plenary legislative power 'on the subject of Bankruptcies.' "). In In re Klein, Justice Catron describes a "general and unlimited" power that "gives the unrestricted authority to [C]ongress over the entire subject, as the parliament of Great Britain had it, and as the sovereign states of this Union had it before the time when the [C]onstitution was adopted."[24] 14 F. Cas. at 717, 42 U.S. 277.

44. When courts do discuss the boundary of the bankruptcy power, it is usually in reference to the uniformity requirement mentioned in the Bankruptcy Clause, and uniformity is frequently referenced as the singular restriction. See Siegel, 596 U.S. at 476, 142 S.Ct. 1770 ("Although the Bankruptcy Clause confers broad authority on Congress, the Clause also imposes *a* limitation on that authority: the requirement that the laws enacted be 'uniform.' " (emphasis added)); Gibbons, 455 U.S. at 468, 102 S.Ct. 1169 ("Unlike the Commerce Clause, the Bankruptcy Clause itself contains *an* affirmative limitation or restriction upon Congress' power: bankruptcy laws must be uniform throughout the United States." (emphasis added)); Kunzler v. Kohaus, 5 Hill 317, 324 (N.Y. 1843) ("The power conferred is without restriction, save in its uniformity."). The court does not place excessive emphasis on one word, particularly an extremely short one,

but it is notable that uniformity is described as *the* limitation on the bankruptcy power and not one of the limitations or even the primary one. But see Tabb, *supra*, at 767 ("Two limits appear in the Clause: that the law be 'uniform,' and that it be 'on the subject of Bankruptcies.' ").

45. As suggested by a broad and supreme power that is not moored to its roots in English bankruptcy law, courts and commentators have also described the ability of the Bankruptcy Clause to adapt to changing conditions, once as bluntly as "The concept changes." Wright, 304 U.S. at 513, 58 S.Ct. 1025; see also Cont'l Ill., 294 U.S. at 668, 55 S.Ct. 595 (describing a tendency toward "progressive liberalization" of the bankruptcy power since its inception); Tabb, *supra*, at 804 ("[T]he scope of the constitutional grant on the 'subject of Bankruptcies' has an expansive and elastic reach ...."); *Constitutional Limits*, *supra*, at 567–68 (arguing that even though the automatic stay and discretionary injunction did not exist in early bankruptcy law, they are part of the "subject of Bankruptcies" because they are "logical developments"). "Congress is not limited by what has been attempted in the past but may shape its remedies in a way to meet adequately the problems of the present." Campbell, 75 F.2d at 955. Throughout the history of American bankruptcy law, the Supreme Court has determined that various changes of a "fundamental and radically progressive nature" are within Congress's power pursuant to the Bankruptcy Clause. Marshall, 300 B.R. at 520 (quoting Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 588, 55 S.Ct. 854, 79 L.Ed. 1593 (1935)). But see *Constitutional Limits*, *supra*, at 500 (claiming the "subject of Bankruptcies" has not changed since the adoption of the Bankruptcy Clause and descriptions of the subject as constantly expanding are "both superficial and myopic").

***15 [21] [22] [23] [24]** 46. Despite forswearing the ability to do so, the Supreme Court has occasionally offered or endorsed definitions of the bankruptcy power. These definitions, however, tend to "result in little more than a paraphrase [25] of the language of the Constitution without advancing far toward its full meaning." Cont'l Ill., 294 U.S. at 669–70, 55 S.Ct. 595. Bankruptcy jurisdiction "extends to all cases where the law causes to be distributed the property of the debtor among his creditors; this is its least limit. Its greatest is a discharge of the debtor from his contracts. And all intermediate legislation, affecting substance and form, but tending to further the great end of the subject—distribution and discharge—are in the competency and discretion of [C]ongress." Klein, 14 F. Cas. at 718; see *Constitutional Limits*, *supra*, at 538 (noting that the Supreme Court has repeatedly expressed its approval of the Klein definition (citing United States v. Bekins, 304 U.S. 27, 47, 58 S.Ct. 811, 82 L.Ed. 1137 (1938); [26] Radford, 295 U.S. at 588 n.18, 55 S.Ct. 854; Cont'l Ill., 294 U.S. at 669, 55 S.Ct. 595; Moyses, 186 U.S. at 186, 22 S.Ct. 857)). The "subject of Bankruptcies" is "not, properly, anything less than the subject of the relations between an insolvent or non-paying or fraudulent debtor, and his creditors, extending to his and their relief." Reiman, 20 F. Cas. at 496; see *Constitutional Limits*, *supra*, at 540 n.291 (noting that the Supreme Court endorsed the Reiman definition in Wright, 304 U.S. at 513–14, 58 S.Ct. 1025, Radford, 295 U.S. at 588 n.18, 55 S.Ct. 854, Cont'l Ill., 294 U.S. at 672–673, 55 S.Ct. 595, and Moyses, 186 U.S. at 187, 22 S.Ct. 857). "[T]he restructuring of debtor-creditor relations ... is at the core of the federal bankruptcy power ...." N. Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 71, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982).

47. While the language of the Bankruptcy Clause, the history of American bankruptcy law, and the Supreme Court's descriptions of the bankruptcy power do not definitively answer, or even directly address, the question of whether constitutional subject matter jurisdiction requires a debtor in financial distress, [27] the absence of support for the Committee's argument is conspicuous. There are simply no cases at any level (of which this court is aware) that explicitly endorse the proposition that bankruptcy courts do not have subject matter jurisdiction unless a debtor has a sufficient degree of financial distress. See Aldrich, 2023 WL 9016506, at *4, *16, *33 (observing that there are no cases that hold that financial distress is a constitutional or jurisdictional requirement for debtors). With no precedent for the exact relief it seeks, the Committee argues its position primarily by focusing on the historical meaning of bankruptcy, see May 17, 2023 Hr'g Tr. 24:12–25:9 (discussing bankruptcy in ancient Greece, Rome, and Europe); id. at 28:15–33:8 (discussing the meaning of bankruptcy from "back in the day" (1777) through the present), references to insolvency and other terms suggesting financial difficulty in dicta, see Committee's Motion at 11 ("I read the constitution thus: 'Congress shall have power to establish uniform laws on the subject of any person's general *inability* to pay his debts.' " (quoting (and adding emphasis to) Kunzler, 5 Hill at 321)); id. at 12 ("The subject of bankruptcies is nothing less than 'the subject of the relations between an *insolvent or nonpaying or fraudulent debtor*, and his creditors, extending to his or their relief.' " (quoting (and adding emphasis to) Wright, 304 U.S. at 513–14, 58 S.Ct. 1025)); id. at 13 ("[T]he

'Bankruptcy Code strikes a balance between the interests of *insolvent debtors and their creditors*.' " (quoting (and adding emphasis to) Bartenwerfer v. Buckley, 598 U.S. 69, 72, 143 S.Ct. 665, 214 L.Ed.2d 434 (2023)), and the pleas of commentators about how the bankruptcy system should work (which is not always the same as how it actually operates), see Judith K. Fitzgerald, *Over-Thinking Ramifications of the Dismissal of LTL Management LLC's Bankruptcy*, HARV. L. SCH. BANKR. ROUNDTABLE (Feb. 14, 2023), https://bankruptcyroundtable.law.harvard.edu/2023/02/14/texas-two-step-and-thefuture-of-mass-tort-bankruptcy-series-postscript-and-analysis-of-third-circuit-dismissal-of-ltl-managements-bankruptcy/ (claiming the LTL Opinion "determined that the need for some form of imminent and demonstrable financial relief is foundational to invoking bankruptcy jurisdiction" [28]); Ralph Brubaker, *The Texas Two-Step and Mandatory Non-Opt-Out Settlement Powers*, HARV. L. SCH. BANKR. ROUNDTABLE (July 12, 2022), https://bankruptcyroundtable.law.harvard.edu/2022/07/12/texas-two-step-and-thefuture-of-mass-tort-bankruptcy-series-the-texas-two-step-and-mandatory-non-opt-out-settlement-powers/ (theorizing that the risk of solvent defendants undercompensating their victims might be acceptable when there is "a clear and present threat to entity viability"); *Constitutional Limits*, *supra*, at 492, 545 (arguing that insolvency is a jurisdictional requirement for bankruptcy).

***16** **[25]** 48. It is not surprising that the popular understanding of the term "bankruptcy" relates to insolvency or that many bankruptcy opinions include references to insolvency, see, e.g., Wright, 304 U.S. at 513–14, 58 S.Ct. 1025 (quoting Reiman, 20 F. Cas. at 496), since most debtors are insolvent, see In re Ultra Petroleum Corp., 51 F.4th 138, 142 (5th Cir. 2022) ("Bankruptcy is ordinarily for the insolvent."); Aldrich, 2023 WL 9016506, at *17 (observing that "the vast majority" of debtors are insolvent and financially distressed); *Constitutional Limits*, *supra*, at 488 ("[M]ost proceedings under the Code do involve insolvent debtors ...."). Potential debtors normally do not want to subject themselves to the disclosure requirements and negative societal ramifications (like public disapproval/embarrassment and, for publicly-traded companies, stock market consequences) of a bankruptcy filing unless they have no other option, and they normally have other options until they are insolvent or very close to it. [29] Cf. Kennedy, *supra*, at 980 ("A debtor contemplating reorganization under Chapter XI frequently postponed the filing of the petition until losses and deterioration of his financial condition frustrated efforts to accomplish any realistic rehabilitation."). Some commentators argue in favor of a jurisdictional insolvency requirement, see, e.g., *Bankruptcy and Federalism*, *supra*, at 1064 & 1129 (arguing that Congress can only overrule state law to alter the relationship between insolvent debtors and creditors); *Constitutional Limits*, *supra*, at 488, 492, 545 (claiming that insolvency is a jurisdictional requirement), but courts, including this one, have rejected a rule requiring debtors to be insolvent, see, e.g., LTL, 64 F.4th at 102 (noting the lack of an insolvency requirement); Bestwall, 605 B.R. at 49 ("[F]iling for Chapter 11, especially in the context of an asbestos or mass tort case, need not be due to insolvency."); In re Mid-Valley, Inc., 305 B.R. 425, 429 (Bankr. W.D. Pa. 2004) (Fitzgerald, J.) ("The Bankruptcy Code does not require that a debtor be insolvent."); Marshall, 300 B.R. at 509 (holding that the Bankruptcy Clause does not require insolvency), 519 ("[I]t is not credible that the framers of the Constitution thought that a requirement of insolvency was included in the concept of bankruptcy that found its way into the Bankruptcy Clause."), and no court has held that insolvency is a prerequisite for constitutional subject matter jurisdiction. References to insolvency in bankruptcy opinions are dicta, see, e.g., Bartenwerfer, 598 U.S. at 72, 143 S.Ct. 665 (referring to the Bankruptcy Code's balance between insolvent debtors and creditors in the first sentence of the opinion); Kunzler, 5 Hill at 320 (asserting that "bankruptcy" is synonymous with "insolvency"), and the court is not bound by dicta, see Katz, 546 U.S. at 363, 126 S.Ct. 990 (citing Cohens v. Virginia, 6 Wheat. 264, 399–400, 5 L.Ed. 257 (1821)).

49. In addition, "insolvency" and "financial distress" do not mean the same thing, LTL, 64 F.4th at 102 ("To say, for example, that a debtor must be in financial distress is not to say it must necessarily be insolvent."), and the Committee explicitly and emphatically rejects the concept of an insolvency requirement for bankruptcy jurisdiction, Official Committee of Asbestos Claimants' Consolidated Reply in Support of the Committee's Motion to Dismiss for Lack of Subject Matter Jurisdiction (Dkt. 2993) ("Committee's Reply") at 8 ("[T]he Committee ***does not*** argue that an entity must be insolvent to file for bankruptcy."). There are several ways to define "insolvency," two of which are regularly used in bankruptcy: (1) balance sheet insolvency, and (2) the liquidity (or "equity" or "cash flow") test for insolvency. Marshall, 300 B.R. at 511–513. Generally, balance sheet insolvency means a debtor's total debt exceeds the value of its property. *Balance-sheet insolvency*, BLACK'S LAW DICTIONARY (9th ed. 2009) ("Insolvency created when the debtor's liabilities exceed its assets."). The Bankruptcy

Code includes its own modified versions of balance sheet insolvency applicable to entities other than municipalities. 11 U.S.C. § 101(32)(A)–(B). Courts use the Code's versions of balance sheet insolvency primarily "to define narrowly drawn rights under particular statutory provisions," Marshall, 300 B.R. at 512 (citing §§ 365, 525, 541, 543, 545, 546, 547, 548, 553), and they are not used to determine debtor eligibility.

50. The liquidity test for insolvency does not compare a debtor's assets and liabilities. Instead, it looks at whether a debtor is promptly paying its debts. *Equity insolvency*, BLACK'S LAW DICTIONARY (9th ed. 2009) ("Insolvency created when the debtor cannot meet its obligations as they fall due."). The Bankruptcy Code includes a version of the liquidity test in section 101(32)(C) that courts use to determine the eligibility of municipalities to file bankruptcy under Chapter 9. See § 109(c)(3).[30] It is the only type of insolvency ever used to determine debtor eligibility for bankruptcy in the United States. Marshall, 300 B.R. at 512.

***17** **[26]** 51. While insolvency examines whether a debtor's liabilities exceed its assets (literally for balance sheet insolvency and figuratively under the liquidity test), financial distress is a more nebulous concept that implies a less severe degree of financial trouble than insolvency. The LTL Opinion, which the Committee (understandably) puts great stock in, does not attempt to define "financial distress." LTL, 64 F.4th at 102 ("[W]e need not set out any specific test to apply rigidly when evaluating financial distress."), 110 ("[W]hile it is unwise today to attempt a tidy definition of financial distress justifying in all cases resort to Chapter 11, we can confidently say the circumstances here fall outside those bounds."). The concept is so vague that the Committee does not attempt to precisely define it despite asking this court to determine that it is implicitly required by the Bankruptcy Clause. See Committee's Motion at 20 (asserting that "[t]his court need not determine where the constitutional line is" because it is so clear that the Debtor is not in financial distress). The court accepts the Committee's argument that the Debtor has never been in financial distress in the sense that its access to the funding agreement, and, therefore, Georgia-Pacific's assets, makes it able to pay any conceivable liabilities now and in the foreseeable future (and the Debtor does not argue to the contrary), but the requirements of constitutional subject matter jurisdiction, especially given the potentially drastic consequences of the lack thereof, see *infra* ¶ 53, need to be definable. As previously noted, no court has ever concluded that financial distress is a requirement for constitutional subject matter jurisdiction, and there is some indication in the case law that it is not, see, e.g., United States v. Huebner, 48 F.3d 376, 379 (9th Cir. 1994) ("The Bankruptcy Act[31] does not require any particular degree of financial distress as a condition precedent to a petition seeking relief."); Rudd v. Laughlin, 866 F.2d 1040, 1041–42 (8th Cir. 1989) ("[T]he statutes governing the authority of federal courts to hear bankruptcy cases do not limit jurisdiction according to amounts involved."); In re Honx, Inc., No. 22-90035, 2022 WL 17984313, at *2 (Bankr. S.D. Tex. Dec. 28, 2022) (concluding that a debtor with asbestos liability did not commence its case in bad faith because "Congress recognized that ... an asbestos bankruptcy differs from a 'classic' bankruptcy with an insolvent or near-insolvent debtor"); In re Gen. Growth Props., Inc., 409 B.R. 43, 60 (Bankr. S.D.N.Y. 2009) (declining to establish a rule that debtors cannot file bankruptcy unless their debt is due within a particular period of time); In re Mirant Corp., No. 03-46590, 2005 WL 2148362, at *12–13 (Bankr. N.D. Tex. Jan. 26, 2005) (using laches to deny motions to dismiss despite allegation that the debtor "was highly solvent and financially healthy on the date of its bankruptcy filing and has continued to be so since that date").

52. Given the lack of support in bankruptcy history for a financial distress requirement, the relative abundance of references to insolvency (and, at least in relevant scholarship, support for an insolvency requirement), and the similarity of the two concepts (i.e., both look at the financial problems of a debtor), it is not surprising or unreasonable for the Committee to use references to insolvency to support its argument, but the Committee's rejection of the implications of most of the authorities it cites for support undermines its position. For example, the Committee says "a debtor's eligibility to be a proper 'subject of Bankruptc[y]' within the meaning of the Bankruptcy Clause 'is a jurisdictional requirement for invoking a bankruptcy proceeding,' " quoting Professor Plank. Committee's Motion at 17 (quoting *Constitutional Limits*, *supra*, at 492). Professor Plank's full assertion, however, is that "[t]he *insolvency* of the debtor in this sense [i.e., in the sense of balance sheet or liquidity insolvency] is a jurisdictional requirement for invoking a bankruptcy proceeding." *Constitutional Limits*, *supra*, at 492 (emphasis added). The Committee uses Professor Plank's contention, which advocates a position that the Committee explicitly disclaims (that insolvency is a jurisdictional requirement), to support its claim that a different concept, financial distress, is a jurisdictional requirement. Similarly, the LTL Opinion prompted the Committee's Motion to some extent, see Committee's Motion at 9 ("In light of the *LTL Mgmt.*

decision ... , the Committee believes that the Court should now address whether Bestwall is constitutionally eligible to be a debtor in bankruptcy." (footnote omitted)), and the Committee cites it for support, see May 17, 2023 Hr'g Tr. 18:8–10 ("[T]he language in LTL is entirely consistent with what we believe is the constitutional limitation on a company that seeks to access the bankruptcy laws."). In that case, however, the Third Circuit determined that it and the bankruptcy court below had subject matter jurisdiction, LTL, 64 F.4th at 99 ("The Bankruptcy Court had jurisdiction of the bankruptcy case under, *inter alia*, 28 U.S.C. §§ 157(a) and 1334(a). We have jurisdiction of the appeals under 28 U.S.C. § 158(d)(2)(A)." (footnote omitted)), prior to determining that the debtor did not file its case in good faith due to its lack of financial distress, id. at 110. The Committee's need to reach for authorities that advocate a different (but related) argument shows the lack of support for its contention.

***18** 53. One reason for the lack of support for a constitutional financial distress requirement is the difficulty in administering such a rule. Professor Plank, a leading proponent of the insolvency requirement (which no party to this case supports), says "there does not seem to be any principled way" to administer a financial distress requirement. *Constitutional Limits*, *supra*, at 493 n.23. At the hearing on the Motions to Dismiss, the advocates for the requirement disagreed about whether financial distress should be determined at the outset of a case or throughout the proceedings. On the one hand, despite citing post-petition developments as support, the Committee took the position that it was a "gatekeeping or access-to-bankruptcy question," May 17, 2023 Hr'g Tr. 43:19–20, and was not sure what should happen if subsequent events showed a debtor to be solvent, id. at 44:6–10. On the other hand, the attorney representing certain claimants represented by Maune, Raichle, Hartley, French & Mudd, LLC ("Maune Raichle"), id. at 46:22–47:11, and the attorney for Mr. Buckingham, id. at 107:21–108:13, argued that the court has a continuing duty throughout its cases to constantly assess its jurisdiction and dismiss any case, at any point in the case, when a debtor is not in financial distress. The latter position is arguably more consistent with a constitutional jurisdiction requirement since courts must always assess their subject matter jurisdiction, see, e.g., Valley Historic, 486 F.3d at 838 ("We do not find that these principles and our precedent, however, can be read or extended to preclude the bankruptcy court from exercising its unflagging obligation to examine its subject matter jurisdiction at every stage of the proceeding."), but determining that subject matter jurisdiction was lost due to post-petition developments would be contrary to both the Bankruptcy Code and long-standing traditions of bankruptcy practice, see, e.g., § 726(a)(5) & (6) (authorizing payment of interest and refunds to a Chapter 7 debtor when all claims are paid in full); Ultra Petroleum, 51 F.4th at 150 ("For some three centuries of bankruptcy law, courts have held that an equitable exception to the usual rules applies in the unusual case of a solvent debtor.");[32] see also *Bankruptcy & Federalism*, *supra*, at 1112–13 (noting that § 726(a)(5) allows "greater payments to creditors in bankruptcy than they would receive outside of bankruptcy" without addressing the apparent solvency of the debtor's estate in a situation where the provision is invoked). A rule that subject matter jurisdiction is lost when a determination is made post-petition that a debtor is no longer in financial distress would create a perverse incentive for Chapter 7 trustees, whose compensation is based on the assets recovered, not to find too many assets.[33] Likewise, many Chapter 13 cases end with early discharges and full payments to creditors as a result of the appreciation of the value of real property, an inheritance, or some other financial good fortune. See, e.g., In re Miloni, No. 20-30258, slip op. at 1–2 (Bankr. W.D.N.C. Nov. 8, 2023) (approving sale of debtor's real property with proceeds to pay off Chapter 13 plan at 100% and surplus refunded to the debtor and noting post-petition appreciation of the real property). Under the version of the financial distress rule advocated by Mr. Buckingham and Maune Raichle, these Chapter 13 cases could instead conclude with dismissal due to the court's post-petition loss of subject matter jurisdiction. Bankruptcy courts could also face attempts to revoke confirmation of Chapter 11 and 13 plans and the discharge of debtors after cases close based on allegations of a lack of financial distress. Cf. In re Tatsis, 72 B.R. 908, 911 (Bankr. W.D.N.C. 1987) ("There are many instances in which Chapter 13 cases are filed where the qualifications of the debtor under § 109(e) might be called into question. In such a case, when no issue is raised by a party in interest, the case will be administered pursuant to Chapter 13. Can someone then come one, two, or three years after confirmation and question the jurisdiction of the court? Can a creditor sue a debtor after his discharge in Chapter 13, alleging that the bankruptcy court never had jurisdiction? These are questions that Congress never intended this Court or any other bankruptcy court be required to answer.").

54. Whether assessed only at the beginning of a case or throughout, determining whether a debtor is in financial distress would not be easy. As previously mentioned, the Committee is not concerned with a standard for the

determination because it asserts that this case is not a close call. See Committee's Reply at 16 ("Experience up until now has not required courts to further clarify those limits (and even now this Court does not have to define the dividing line)."). But a constitutional rule would apply to all of the cases before the court, now and in the future, so the court needs to have some idea of how to enforce it. Other courts and commentators have noted the difficulty of enforcing a theoretical insolvency rule, see, e.g., Marshall, 300 B.R. at 513 (noting the extensive amount of time necessary to make a solvency determination); *Constitutional Limits*, *supra*, at 493 ("To be sure, whether and when a debtor becomes insolvent in either sense may present difficult factual and conceptual questions."), and insolvency is a defined and familiar concept compared to financial distress. [34] Any consideration of the practicalities of a financial distress rule leads to more questions than answers. The Committee and its allies may not be concerned with the logistics of applying its rule in contexts other than this unusual case, but the court would have to apply a constitutional rule across the board, and very few debtors have access to the resources of Fortune 500 companies.

55. Another problem with a financial distress requirement for subject matter jurisdiction is the tension with the goal of getting potential debtors to commence their cases early. In adopting the Bankruptcy Code, Congress saw the benefit in incentivizing Chapter 11 debtors to file their cases in time to maintain the value of their estates and avoid liquidation. [35] Gen. Growth, 409 B.R. at 60; In re Johns-Manville Corp., 36 B.R. 727, 736 (Bankr. S.D.N.Y. 1984); Kennedy, *supra*, at 980–81; REPORT, *supra*, at 75. Under the Committee's rule, however, debtors would have to thread the needle between filing early enough to preserve value as encouraged by the Code but not filing too early and therefore facing dismissal (or the threat thereof) for an absence of sufficient financial distress. In addition, the assessment of financial distress by courts would itself cause some loss of value. Cf. Marshall, 300 B.R. at 513 ("If a reorganization is held up pending a determination of balance sheet insolvency, businesses will rarely be reorganized, and at least some of the reorganization value (the value of a business as reorganized as opposed to its liquidation value) will inevitably be lost.").

***19** 56. Consistent with a policy decision to allow liberal access and encourage early filing, Congress did not make the statutory subject matter jurisdiction requirements for bankruptcy very strenuous. While the instant dispute focuses on the Constitution, the court notes that this case satisfies the modest statutory requirements for subject matter jurisdiction. Section 1334 of Title 28 determines statutory subject matter jurisdiction for bankruptcy. Kirkland, 600 F.3d at 315; Valley Historic, 486 F.3d at 839 n.3; Houck v. Lifestore Bank (In re Houck), Ch. 13 Case No. 11-51513, Adv. No. 15-5028, 2018 WL 722462, at *7 (Bankr. W.D.N.C. Feb. 5, 2018). Section 1334(a) gives district courts jurisdiction over the administration of bankruptcy cases, and section 1334(b) provides district courts with jurisdiction over all of the discrete proceedings within the cases. Houck, 2018 WL 722462, at *7. Section 157 of Title 28 allows district courts to send bankruptcy matters to bankruptcy courts, and the District Court's April 14, 2014 Amended Standing Order of Reference sends all local cases to this court. The statutes that establish the subject matter jurisdiction of the bankruptcy court do not look at financial distress, insolvency, or any other characteristics of debtors.

[27] **[28]** 57. Accordingly, if Congress decided to add a financial distress requirement for debtors in bankruptcy, it would most likely not implicate the subject matter jurisdiction of the court. Congress would likely add the requirement to section 109, which "defines who may be a debtor under the various chapters of the Code." Toibb v. Radloff, 501 U.S. 157, 160, 111 S.Ct. 2197, 115 L.Ed.2d 145 (1991); see also Kennedy, *supra*, at 986 (similar). Section 109's requirements for debtor eligibility are not jurisdictional. In re Zarnel, 619 F.3d 156, 169 (2d Cir. 2010); Rudd, 866 F.2d at 1042 (citations omitted); see also In re Phillips, 844 F.2d 230, 235 n.2 (5th Cir. 1988) (section 109(g) is not jurisdictional); In re Stinnie, 555 B.R. 530, 533 (Bankr. W.D. Va. 2016) (section 109(h) is not jurisdictional); In re Baxter, Ch. 7 Case No. 06-30452, slip op. at 8 (Bankr. W.D.N.C. May 17, 2006) (section 109(h) is not jurisdictional). But see In re Keziah, 46 B.R. 551, 554 (Bankr. W.D.N.C. 1985) ("§ 109 is a part of the eligibility (to be a debtor) section which involves the subject matter jurisdiction of this Court."). [36] In municipal bankruptcies, which do require insolvency, the requirement is in section 109(c), and it is not jurisdictional. Hamilton Creek, 143 F.3d at 1385 n.2. A bankruptcy case commences even if a debtor is not eligible under a particular chapter, see, e.g., Tatsis, 72 B.R. at 910 ("Movant argues that in the event a debtor files a petition pursuant to Title 11, but chooses a chapter for which he is not qualified, then there is no jurisdiction of any kind or type in the court and the filing is a nullity. This argument is incorrect."), or at all, see, e.g., Zarnel, 619 F.3d at 169 ("[W]e find that the restrictions of § 301 and § 109(h) are not jurisdictional, but rather elements that must be established to sustain a voluntary bankruptcy proceeding."); see also Kennedy, *supra*, at 983 ("Filing the petition results in an automatic entry of an order for relief under the chapter invoked by the petition. The expression 'order for relief' in the Code is equivalent to adjudication under the Bankruptcy Act and is tantamount to an order approving the court's exercise of jurisdiction to grant relief pursuant to the provisions of the law. If the debtor is ineligible or the petition is insufficient, however, the language of the statute does not preclude the court from taking whatever action is appropriate to dispose of the document." (footnotes omitted)); REPORT, *supra*, at 75 ("There should be no legal barrier to voluntary petitions."). If debtor eligibility was an element of subject matter jurisdiction, a case commenced by an ineligible debtor would instead be void. See Baxter, slip op. at 7 ("Some courts maintain that compliance with Section 109(h) is jurisdictional and a filing by a debtor who does not qualify is a nullity." (citations omitted)); cf. Arbaugh, 546 U.S. at 514, 126 S.Ct. 1235 ("[W]hen a federal court concludes that it lacks subject-matter jurisdiction, the court must dismiss the complaint in its entirety." (citing 16 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE § 106.66[1], at 106-88 to 106-89 (3d ed. 2005)).

***20** 58. In part due to the harsh results of a decision that subject matter jurisdiction is lacking, the Supreme Court has been trying "to bring some discipline" to the jurisdictional analysis in recent years. MOAC, 598 U.S. at 298, 143 S.Ct. 927 (quoting Henderson v. Shinseki, 562 U.S. 428, 435, 131 S.Ct. 1197, 179 L.Ed.2d 159 (2011)). The Eleventh Circuit, applying the Supreme Court's guidance in the bankruptcy context, noted that "the failure of a cause of action does not automatically produce a failure of jurisdiction." In re Trusted Net Media Holdings, LLC, 550 F.3d 1035, 1042 (11th Cir. 2008) (quoting Steel Co. v. Citizens for a Better Env't, 523 U.S. 83, 91, 118 S.Ct. 1003, 140 L.Ed.2d 210 (1998)); see also id. at 1043 (concluding that the requirements of § 303 for involuntary cases are not jurisdictional). The Supreme Court addressed subject matter jurisdiction multiple times in 2023, including a determination of whether a bankruptcy statute implicated subject matter jurisdiction. See MOAC, 598 U.S. at 292, 143 S.Ct. 927 (deciding that § 363(m) is not jurisdictional); Santos-Zacaria, 598 U.S. at 413, 143 S.Ct. 1103 (holding that an immigration law (8 U.S.C. § 1252(d)(1)) is not jurisdictional). In MOAC, the Court observed that "[t]he 'jurisdictional' label is significant because it carries with it unique and sometimes severe consequences." 598 U.S. at 297, 143 S.Ct. 927. While these decisions deal with statutory subject matter jurisdiction, they suggest the Supreme Court would not favor expansive new ideas about constitutional subject matter jurisdiction for similar reasons.

59. There is no need for a harsh new jurisdictional rule because there are other ways for courts to address any perceived abuse by debtors lacking financial distress. Cf. *Constitutional Limits*, *supra*, at 555 ("The requirement of good faith, the ability to lift the automatic stay for cause, and the discretion to disapprove rejection of contracts may be sufficient to prevent solvent debtors from abusing the bankruptcy process."). As previously noted, the LTL Opinion is a basis for the Committee's Motion. See *supra* ¶¶ 51–52. In contrast with the Committee's Motion, however, the Third Circuit decided that it had jurisdiction, LTL, 64 F.4th at 99, and dismissed the LTL case pursuant to section 1112(b) because the debtor could not show that it commenced its case in good faith due to its lack of financial distress, id. at 110.[37] The LTL Opinion is not the only example of a court using good faith to police against financially healthy debtors abusing the bankruptcy system. See, e.g., In re Cedar Shore Resort, Inc., 235 F.3d 375, 381 (8th Cir. 2000) ("Nor did the bankruptcy court abuse its discretion in dismissing Cedar Shore's petition. Congress designed Chapter 11 to give those businesses 'teetering on the verge of a fatal financial plummet an opportunity to reorganize on solid ground and try again, not to give profitable enterprises an opportunity to evade contractual or other liability.' " (quoting Furness v. Lilienfield, 35 B.R. 1006, 1009 (D. Md. 1983))); In re SGL Carbon Corp., 200 F.3d 154, 164 (3d Cir. 1999) ("SGL Carbon cites no case holding that petitions filed by financially healthy companies cannot be subject to dismissal for cause."); *Constitutional Limits*, *supra*, at 548–551 (collecting cases). Some courts even find "cause" under section 362 to grant relief from the automatic stay when a debtor files a case in bad faith. See, e.g., In re Corp. Deja Vu, 34 B.R. 845, 850 (Bankr. D. Md. 1983) ("The petition was filed in bad faith. This bad faith constitutes cause to allow the secured creditor relief from the stay."); *Constitutional Limits*, *supra*, at 551 (citing In re Dixie Broad., Inc., 871 F.2d 1023 (11th Cir.), *cert. denied*, 493 U.S. 853, 110 S.Ct. 154, 107 L.Ed.2d 112 (1989)). In addition, some courts deny access to special bankruptcy rules and protections based on a debtor's solvency without examining good faith. See, e.g., Claughton v. Mixson, 33 F.3d 4, 6–7 & n.4 (4th Cir. 1994) (affirming bankruptcy court's lifting of stay due to debtor's solvency); *Constitutional Limits*, *supra*, at 551–52 (collecting cases including Claughton). There are many tools available for bankruptcy courts to deal with a debtor's lack of financial distress without a new rule of subject matter jurisdiction.

***21** 60. Based primarily on its analysis of the history of the Bankruptcy Clause and the Supreme Court's interpretation of Congress's expansive power pursuant to it, this court holds that financial distress is not a prerequisite for bankruptcy subject matter jurisdiction pursuant to the Constitution. Instead, the court joins others that have held that the subject matter jurisdiction for bankruptcy extends to all cases filed under the Bankruptcy Code. See, e.g., Zarnel, 619 F.3d at 169 ("Restricting whether an individual may be a debtor either under the Bankruptcy Code in general or under a given chapter does not speak in jurisdictional terms or invoke the jurisdiction of the district court, delineated in 28 U.S.C. § 1344 as discussed above."); Rudd, 866 F.2d at 1041 ("When a petition is filed in a bankruptcy court seeking assistance in 'the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power,' the court has jurisdiction to administer the ensuing case in accordance with Title 11 of the United States Code." (quoting N. Pipeline, 458 U.S. at 71, 102 S.Ct. 2858)); Auto. Pros., 370 B.R. at 167 (citing Phillips, 844 F.2d at 236 n.2); Baxter, slip op. at 7–8 (agreeing with courts that take the position that "it is the petition that invokes the bankruptcy court's jurisdiction, not the debtor's characteristics"); see also Mussman & Riesenfeld, *supra*, at 92 ("The jurisdiction of the court attaches from the filing of the petition ...."). The Founding Fathers, like many contemporary observers, might be surprised that an entity like the Debtor with access to significant financial resources has sought bankruptcy protection. Their presumed astonishment, however, does not mean that the Debtor has violated the subject matter jurisdiction of the bankruptcy court, and the question of whether the Debtor should be able to access the bankruptcy system is different than the question of whether the Constitution bars it. Accordingly, the court emphasizes the limited nature of this jurisdictional ruling. The court is not making a policy judgment that a debtor without financial distress should be able to file bankruptcy; it is simply deciding that the limited language of the Bankruptcy Clause, as interpreted by the Supreme Court over the last 250 years, does not prevent the Debtor from doing so.

Conclusion

While framed as new arguments, the Buckingham Motion and portions of the Committee's Motion actually seek reconsideration of this court's prior Opinion and Order on the Debtor's good faith without satisfying the standard for reconsideration. The law of the case doctrine counsels against a court straying from its previous legal conclusions. Furthermore, the divestment rule prevents a court from addressing issues on appeal, and the Committee's attempt to appeal the Opinion and Order was pending in the District Court when the Motions to Dismiss were filed, argued, and ruled on.

In addition to the good faith argument, the Committee's Motion asserts a new basis for dismissal: an absence of constitutional subject matter jurisdiction based on the Debtor's lack of financial distress. After analyzing the Bankruptcy Clause of the Constitution and its interpretation by the Supreme Court, other courts, and outside commentators, the court is confident that the Constitution does not require debtors to have financial distress in order for bankruptcy courts to have subject matter jurisdiction. The court's conclusion is buttressed by the complete lack of support for the Committee's novel argument in the relevant case law, the practical problems with a jurisdictional financial distress requirement, the policy decision to encourage potential debtors to file their cases early, the Supreme Court's recent approach to issues of subject matter jurisdiction, and the ability of bankruptcy courts to use other tools to address the problem asserted by the Committee.

Based on these findings and conclusions, and for the additional reasons set forth on the record at the July 28, 2023 hearing (which record is incorporated herein), the Motions to Dismiss are hereby **DENIED**.

SO ORDERED.

All Citations

--- B.R. ----, 2024 WL 721596

Footnotes

1 Docket references in this order are to the docket for this case unless otherwise indicated.

2 The court's jurisdictional conclusions are explained in (far) more depth later in this order. See *infra* ¶¶ 25–60.

3 This is an oversimplified description of the divisive merger performed by Old GP intended to provide sufficient context for the following discussion of the Motions to Dismiss. While the Texas Two-Step transaction informs the entirety of this case, it is not directly relevant to the Motions to Dismiss. See, e.g., May 17, 2023 Hr'g Tr. 136:11–14 (Buckingham's counsel answering "Absolutely" when asked by the court if the Buckingham Motion would have been filed if there was no divisional merger and the debtor in this case was Georgia-Pacific).

4 Subsequent statutory references in this order are to Title 11 unless otherwise indicated.

5 In its Certification for Direct Appeal, the court concluded that directly certifying the appeal to the Court of Appeals materially advanced the Debtor's case because the issue of reconsidering the Carolin standard would require a determination by the Fourth Circuit. Certification for Direct Appeal at 3. The court also concluded that the Opinion and Order involved a matter of public importance because the pre-petition restructuring created an issue of first impression in the Fourth Circuit regarding the subjective bad faith prong of the Carolin standard that "transcends this case, its litigants, and asbestos cases in general." Certification for Direct Appeal at 4.

6 "W.D.N.C." docket references are to the District Court's docket in case no. 19-396, the Committee's appeal of the Opinion and Order.

7 The Debtor further explains that in its jurisdictional analysis, the Fourth Circuit "rejected the Committee's attempts to invoke the [LTL Opinion] because, among other things, the Fourth Circuit 'applies a more comprehensive standard' for a bad-faith dismissal than the Third Circuit, looking to both 'subjective bad faith' and 'objective futility of any possible reorganization.' " Debtor's Notice at 1–2 (quoting Off. Comm. of Asbestos Claimants, 71 F.4th at 182).

8 Subsequent to the court issuing its oral ruling on the Motions to Dismiss but prior to the entry of this order memorializing that ruling, the District Court entered an Order on November 7, 2023 denying the Committee's motion for leave to appeal, denying as moot the Debtor's Motion for Leave, and dismissing the Committee's appeal. In re Bestwall LLC, No. 19-cv-00396, slip op. at 10, 2023 WL 7361075 (W.D.N.C. Nov. 7, 2023). The District Court first concluded that the Opinion and Order is not appealable as a final order. Id. at 4–7. It then considered and denied the Committee's request for leave to appeal the Opinion and Order. Id. at 7–10. The District Court concluded that: (1) an appeal of the Opinion and Order does not involve a controlling question of law because this court applied Carolin, which is binding law in this circuit; (2) "there is not substantial ground for difference of opinion" about the test to use in the context of motions to dismiss under section 1112(b) in the Fourth Circuit; and (3) the Committee had not shown the exceptional circumstances required to ignore the policy of postponing appellate review until a final judgment has been entered. Id. at 9–10.

9 "A.P." docket references are to this court's docket in adversary proceeding no. 17-3105.

10 In his reply in support of the Buckingham Motion and in his oral argument at the hearing on March 15, 2023, Mr. Buckingham's counsel characterized his argument as one of subject matter jurisdiction. However, at the May 17, 2023 hearing, Mr. Buckingham's counsel seemed to abandon that argument and focused on dismissal of the case as a bad faith filing under Carolin. See, e.g., May 17, 2023 Hr'g Tr. 118:10–17.

11 In non-bankruptcy federal litigation like Levin, the district court is the trial court, and the court of appeals is the (initial) appellate court. In bankruptcy matters, the bankruptcy court is the trial court, and the initial appeal goes to the district court (or, in certain other circuits, a bankruptcy appellate panel). See, e.g., FED.

R. BANKR. P. 8003 (Appeal as of Right—How Taken; Docketing the Appeal), 8005 (Election to Have an Appeal Heard by the District Court Instead of the BAP).

12 After the District Court's November 7, 2023 decision not to allow an interlocutory appeal of this court's ruling on the First Motion to Dismiss, Mr. Buckingham filed a Notice of Supplemental Authority (Dkt. 3172) that reports the District Court's denial of the Committee's motion for leave to appeal and asks the court to rule on the merits of his motion to dismiss. The court declines the invitation. First, the court announced its ruling at the July 28, 2023 hearing, prior to the District Court's denial of the Committee's motion for leave to appeal, and this order memorializes that ruling. In addition, and more importantly, even if the District Court's ruling occurred prior to the July 28 hearing, the court would not have gotten to the merits of the Buckingham Motion. The court already ruled on the bad faith arguments at the heart of the Buckingham Motion, and the end of the appeal would not lead this court to reconsider its previous conclusions for the reasons explained in this order. See, e.g., *supra* ¶ 20.

13 If this debate is not jurisdictional, it is about congressional power pursuant to the Bankruptcy Clause. Aldrich, 2023 WL 9016506, at *12–14.

14 The Debtor's law of the case argument on the subject matter jurisdiction issue focuses on this court's previous conclusion in the Opinion and Order that "[t]he volume of current asbestos claims that Bestwall faced as of the Petition Date, coupled with the projected number of claims to be filed through 2050 and beyond, is sufficient financial distress for Bestwall to seek resolution under section 524(g) of the Bankruptcy Code." Bestwall, 605 B.R. at 49. While the court's previous order speaks for itself, the court was not considering subject matter jurisdiction in that order, and, as the context of the entire sentence makes clear, the court was only considering the evidence before it about the (significant) liabilities faced by the Debtor and was not considering the Debtor's (more significant) assets, cf. LTL, 64 F.4th at 104 ("These cases show that mass tort liability can push a debtor to the brink. But to measure the debtor's distance to it, courts must always weigh not just the scope of liabilities the debtor faces, but also the capacity it has to meet them."); Aldrich, 2023 WL 9016506, at *15 (explaining argument that the court must consider the denominator (i.e., revenues/cash flow) as well as the numerator (i.e., asbestos liability) in determining financial distress).

15 As mentioned *supra* ¶ 8, the Committee's Motion refers to the Debtor's financial situation at its petition date and since then, so it is not clear whether the court should examine the Debtor's alleged lack of financial distress as of the petition date over 6 years ago, now, or both. Similarly and as discussed further *infra* ¶53, at the hearing on the Motions to Dismiss, the advocates for the Committee's position disagreed about whether the court should determine subject matter jurisdiction only as of the petition date or throughout the case.

16 Until the 18th century, bankruptcy and insolvency were two separate (but related) bodies of substantive law. Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 516 (1996) (observing that English bankruptcy and insolvency law began to merge in 1758). The Supreme Court has determined that the Bankruptcy Clause encompasses both types of law. Cont'l Ill. Nat'l Bank & Tr. Co. of Chi. v. Chi., Rock Island & Pac. Ry. Co., 294 U.S. 648, 667–68, 55 S.Ct. 595, 79 L.Ed. 1110 (1935) ("While attempts have been made to formulate a distinction between bankruptcy and insolvency, it long has been settled that, within the meaning of the constitutional provision, the terms are convertible."); Sturges v. Crowninshield, 17 U.S. 122, 195, 4 Wheat. 122, 4 L.Ed. 529 (1819) ("This difficulty of discriminating with any accuracy between insolvent and bankruptcy laws, would lead to the opinion, that a bankrupt law may contain those regulations which are generally found in insolvent laws; and that an insolvent law may contain those which are common to a bankrupt law.") (Marshall, C.J.).

17 There is disagreement among authorities about when both English and American bankruptcy relief became available to debtors who were not traders. See *infra* ¶ 33, nn.19–20.

18 While very few opinions consider a debtor's degree of financial distress, and many of the authorities (including the majority of the sources cited by the Committee as support for its argument) discuss a debtor's financial condition in terms of insolvency, it is important to recognize that "insolvency" and "financial distress" are not synonymous. See *infra* ¶¶ 49–51.

19 Professor Plank claims that English bankruptcy law of the 18[th] century had already expanded beyond traders prior to 1787. *Constitutional Limits*, *supra*, at 541 n.309.

20 Marshall says the "second landmark major development" of the 1841 Act was the extension of bankruptcy law to non-traders. 300 B.R. at 520.

21 The filing of a petition constitutes the "order for relief" in a voluntary case. 11 U.S.C. § 301(b).

22 William Blackstone, whose "*Commentaries* rank second only to the Bible as a literary and intellectual influence on the history of American institutions," William D. Bader, *Some Thoughts on Blackstone, Precedent, and Originalism*, 19 VT. L. REV. 5, 8 (1994) (quoting ROBERT A. FERGUSON, LAW AND LETTERS IN AMERICAN CULTURE 11 (1984)), thoroughly considered English bankruptcy law and did not include insolvency as a requirement. Marshall, 300 B.R. at 517 (citing 2 WILLIAM BLACKSTONE, COMMENTARIES *471–88).

23 *Black's Law Dictionary* defines "plenary" as "Full; complete; entire." *Plenary*, BLACK'S LAW DICTIONARY (9th ed. 2009).

24 Concerns about subject matter jurisdiction presumably did not limit the bankruptcy authority of Parliament and the pre-Constitution states.

25 The lengthier of these definitions might be more like the opposite of a paraphrase since a paraphrase is usually shorter and simpler than the original statement.

26 Despite the citation in *Constitutional Limits*, the Bekins opinion does not actually discuss the Klein definition at all. It does, however, quote the Reiman formulation of the bankruptcy power. Bekins, 304 U.S. at 47, 58 S.Ct. 811.

27 But see Gibbons, 455 U.S. at 476, 102 S.Ct. 1169 (Marshall, J., concurring) ("Congress may specify what debtors ... will be subject to bankruptcy legislation.").

28 Judge Fitzgerald appears to be using the word "jurisdiction" loosely in the quoted phrase. See *infra* n.36, ¶ 58.

29 Texas Two-Step cases like this one, where an existing company (Georgia-Pacific here) creates a separate entity like the Debtor in order to gain access to benefits available only in bankruptcy for itself, appear to be an exception to this rule. Cf. *Bankruptcy and Federalism*, *supra*, at 1095 (contending that an insolvency requirement would prevent solvent debtors from taking advantage of bankruptcy rules that are not available elsewhere).

30 Municipalities must be insolvent to be debtors, but the requirement is included in section 109 and does not implicate the court's subject matter jurisdiction. See In re Hamilton Creek Metro. Dist., 143 F.3d 1381, 1385 n.2 (10th Cir. 1998) (noting that "none of the § 109(c) criteria is [sic] jurisdictional in nature" while determining that a Chapter 9 debtor "did not meet the essential criterion of insolvency"); see also *infra* ¶ 57.

31 Huebner deals with the appeal of tax evasion convictions involving bankruptcy petitions filed in 1985 and 1986, see 48 F.3d at 377–79, well after the effective date of the Bankruptcy Code, so the reference to the Bankruptcy "Act" appears to be in error.

32 The Ultra Petroleum court described its debtor as becoming "supremely solvent," 51 F.4th at 142, "massively solvent," id. at 143, and, fittingly, "ultra solvent," id. at 150, due to a post-petition increase in the price of natural gas.

33 The incentive for a Chapter 7 trustee not to find too many assets could also exist under the Committee's "gatekeeping" version of the financial distress requirement if the recovered assets indicated that a debtor was actually not in financial distress on its petition date.

34 *Black's Law Dictionary* and the Bankruptcy Code do not include definitions for "financial distress."

35 The court acknowledges that the priorities of the Bankruptcy Code would have to yield if financial distress was an element of constitutional subject matter jurisdiction.

36 Keziah is an example of this court not being sufficiently rigorous in its analysis of subject matter jurisdiction. See also *infra* ¶ 58. The reasoning of Keziah has been explicitly and convincingly rejected by the Fifth Circuit, see Phillips, 844 F.2d at 235 n.2, and two years after Keziah, the same judge, the Honorable Marvin R. Wooten, took a contrary jurisdictional position consistent with this order, see Tatsis, 72 B.R. at 910 ("Filing of a case under Title 11 establishes jurisdiction in this Court in accordance with 28 U.S.C. §§ 1334 and 157. It gives the Court the right and authority to administer the case in accordance with the Bankruptcy Code.").

37 As mentioned previously *supra* ¶ 19, the LTL Opinion acknowledges that the good faith analysis is different in the Fourth Circuit and requires objective futility in addition to subjective bad faith. 64 F.4th at 98 n.8 (citing Carolin, 886 F.2d at 694); see also Off. Comm. of Asbestos Claimants, 71 F.4th at 182 (noting that the Fourth Circuit requires "a more comprehensive standard" to be met in order to dismiss a Chapter 11 case for a lack of good faith). The absence of financial distress ironically helps a debtor avoid a bad faith dismissal in this circuit. See Bestwall, 605 B.R. at 49–51 (finding that "Bestwall has the full ability to meet all of its obligations (whatever they may be) through its assets and New GP's assets, which are available through the Funding Agreement" in the course of concluding that this case is not objectively futile and denying the First Motion to Dismiss without addressing subjective bad faith); Aldrich, 2023 WL 9016506, at *27 (observing that all bankruptcy cases filed by solvent debtors without financial distress will survive dismissal under the Carolin standard and wondering if the Carolin court considered the application of its test to such debtors); *33 ("Aldrich and Murray were designed to meet the objective futility standard, and they do."). This case may provide a basis for the Fourth Circuit to reexamine its standard for good faith, at least in Texas Two-Step cases like this one, but it is not a basis to create a new jurisdictional requirement that could have "far-reaching consequences," Phillips, 844 F.2d at 235 n.2.

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KeyCite Yellow Flag - Negative Treatment
Declined to Extend by In re Bestwall LLC, 4th Cir.(N.C.), June 20, 2023

64 F.4th 84
United States Court of Appeals, Third Circuit.

IN RE: LTL MANAGEMENT, LLC, Debtor
LTL Management, LLC
v.
Those Parties Listed on Appendix A to Complaint and John and Jane Does 1-1000
*Official Committee of Talc Claimants, Appellant in case Nos. 22-2003, 22-2004 and 22-2005
*Official Committee of Talc Claimants; Patricia Cook; Evan Plotkin; Randy Derouen; Kristie Doyle, as estate representative of Dan Doyle; Katherine Tollefson; Tonya Whetsel, as estate representative of Brandon Wetsel; Giovanni Sosa; Jan Deborah Michelson-Boyle, Appellants in case Nos. 22-2006, 22-2007 and 22-2008
Arnold & Itkin LLP, on behalf of certain personal injury claimants represented by Arnold & Itkin, Appellant in case No. 22-2009
Aylstock Witkin Kreis & Overholtz PLLC, on behalf of more than three thousand holders of talc claims, Appellant in case Nos. 22-2010 and 22-2011
*(Amended per Court's Order dated 06/10/2022)

Nos. 22-2003, 22-2004, 22-2005, 22-2006, 22-0007, 22-2008, 22-2009, 22-2010, 22-2011
|
Argued September 19, 2022
|
(Opinion filed: January 30, 2023)
|
Entered March 31, 2023

Synopsis
Background: Official committee of talc claimants and law firm on behalf of certain talc personal injury claimants filed motions to dismiss Chapter 11 case of debtor, an indirect subsidiary of manufacturer of talc-based astringent powder which, through corporate restructuring, had assumed responsibility for manufacturer's talc-related liabilities, as not having been filed in good faith. Debtor filed motion seeking extension of order that had been entered by North Carolina bankruptcy court prior to case's transfer to New Jersey, which enjoined third-party claims against certain nondebtor "protected parties." The United States Bankruptcy Court for the District of New Jersey, Michael B. Kaplan, Chief Judge, denied motions to dismiss, 637 B.R. 396, and granted injunction motion, 638 B.R. 291. Talc claimants appealed. Direct appeals to the Third Circuit were authorized, and the appeals consolidated.

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

[1] in evaluating debtor's good faith, the Court of Appeals would consider only the financial condition of debtor, not its pre-bankruptcy predecessor which, due to corporate restructuring, no longer existed;

[2] despite its massive talc-related liabilities, debtor was not in financial distress on the petition date and, thus, it could not show its petition served a valid bankruptcy purpose and was filed in good faith; and

[3] "unusual circumstances" did not preclude dismissal.

Reversed and remanded with instructions.

Opinion, 58 F.4th 738, amended and superseded.

Procedural Posture(s): On Appeal; Motion to Convert or Dismiss Case; Motion for Preliminary Injunction.

West Headnotes (44)

[1] **Bankruptcy** "Good faith."

Good intentions, such as to protect a company's brand or comprehensively resolve litigation, do not suffice, alone, to constitute good faith in filing a Chapter 11 petition; what counts to access the Bankruptcy Code's safe harbor is to meet its intended purposes. 11 U.S.C.A. § 1112(b).

[2] **Bankruptcy** Good Faith; Motive

Only a putative debtor in financial distress may access the Bankruptcy Code's safe harbor by filing a bankruptcy petition.

[3] **Corporations and Business Organizations** Spin-Offs, Split-Offs, and Corporate Divisions

Under Texas law, a "divisional merger" splits a legal entity into two, divides its assets and liabilities between the two new entities, and terminates the original entity. Tex. Bus. Org. Code § 10.001 et seq.

1 Case that cites this headnote

[4] **Bankruptcy** "Bad faith."

Bankruptcy Realistic possibility of reorganization

In the Fourth Circuit, a court can only dismiss a Chapter 11 petition for lack of good faith on a showing of debtor's subjective bad faith and objective futility of any possible reorganization. 11 U.S.C.A. § 1112(b).

3 Cases that cite this headnote

[5] **Bankruptcy** Settlement, adjustment, or enforcement of claims

Bankruptcy Code allows a debtor satisfying certain conditions to establish, in a plan of reorganization, a trust for the benefit of current and future claimants against which an injunction channels all asbestos litigation and, under certain conditions, may also channel claims against third parties affiliated with the debtor. 11 U.S.C.A. § 524(g).

[6] **Bankruptcy** Discretion

Court of Appeals reviews for an "abuse of discretion" the bankruptcy court's denial of motions to dismiss a Chapter 11 petition for lack of good faith; that exists when the decision rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact. 11 U.S.C.A. § 1112(b).

[7] **Bankruptcy** Conclusions of law; de novo review

Bankruptcy Clear error

Court of Appeals gives fresh, that is, plenary or de novo, review to a bankruptcy court's conclusion of law and reviews for clear error findings of fact leading to the decision.

[8] **Bankruptcy** Particular cases and issues

On appeal from a bankruptcy court's decision, facts subject to clear-error review include those that are basic, historical, and narrative events elicited from evidence presented at trial, and those that are inferred, which are drawn from basic facts and are permitted only when, and to extent that, logic and human experience indicate probability that certain consequences can and do follow from basic facts; these are distinguished from an "ultimate fact," which is legal concept with factual component, and examples include negligence or reasonableness.

1 Case that cites this headnote

[9] **Bankruptcy** Scope of review in general

Reviewing ultimate fact decided by the bankruptcy court, the Court of Appeals separates its distinct factual and legal elements and applies appropriate standard to each component.

[10] **Bankruptcy** Conclusions of law; de novo review

Bankruptcy Particular cases and issues

Concluding that a bankruptcy petition is filed in good faith is an ultimate fact, for purposes of appellate review; while the underlying basic and inferred facts require clear-error review, the culminating determination of whether those facts support a conclusion of good faith gets plenary review as essentially a conclusion of law.

1 Case that cites this headnote

[11] **Bankruptcy** Conclusions of law; de novo review

Bankruptcy Particular cases and issues

Bankruptcy court's determination of a debtor's financial distress, like the broader good-faith inquiry of which it is a part, is subject to mixed review; whether financial distress exists depends on the underlying basic facts, such as the debtor's ability to pay its current debts, and inferred facts, such as projections of how much pending and future liabilities, like litigation, could cost it in the future, but the ultimate determination, like with good faith, is essentially a conclusion of law that gets a fresh look.

[12] **Bankruptcy** Good Faith; Motive

Chapter 11 petitions are subject to dismissal unless filed in good faith. 11 U.S.C.A. § 1112(b).

1 Case that cites this headnote

[13] **Bankruptcy** Good Faith; Motive

Lack of good faith constitutes "cause" for dismissal of Chapter 11 petition, though it does not fall into one of the examples of cause specifically listed in the Bankruptcy Code. 11 U.S.C.A. § 1112(b).

[14] **Bankruptcy** Good Faith; Motive

Good-faith requirement for a Chapter 11 petition, though not set forth in the text of the Bankruptcy Code, is grounded in the equitable nature of bankruptcy and the purposes underlying Chapter 11 of the Code. 11 U.S.C.A. § 1112(b).

[15] **Bankruptcy** Proceedings

Once at issue, burden to establish good faith of Chapter 11 petition is on debtor. 11 U.S.C.A. § 1112(b).

[16] **Bankruptcy** Good Faith; Motive

In determining whether Chapter 11 petition was filed in good faith, courts examine the totality of facts and circumstances and determine where a petition falls along the spectrum ranging from the clearly acceptable to the patently abusive. 11 U.S.C.A. § 1112(b).

1 Case that cites this headnote

[17] **Bankruptcy** "Good faith."

Though Chapter 11 debtor's subjective intent may be relevant, good faith in filing bankruptcy petition falls more on objective analysis of whether debtor has sought to step outside equitable limitations of Chapter 11. 11 U.S.C.A. § 1112(b).

[18] **Bankruptcy** "Good faith."

In determining whether Chapter 11 petition was filed in good faith, two inquiries are particularly relevant: (1) whether the petition serves a valid bankruptcy purpose, and (2) whether it is filed merely to obtain a tactical litigation advantage. 11 U.S.C.A. § 1112(b).

1 Case that cites this headnote

[19] **Bankruptcy** "Good faith."

In context of determining whether Chapter 11 petition was filed in good faith, valid bankruptcy purposes include preserving going concern or maximizing value of debtor's estate. 11 U.S.C.A. § 1112(b).

[20] **Bankruptcy** "Good faith."

In context of determining whether Chapter 11 petition was filed in good faith, a valid bankruptcy purpose assumes a debtor in financial distress. 11 U.S.C.A. § 1112(b).

5 Cases that cite this headnote

[21] **Bankruptcy** "Bad faith."

Absent financial distress, there is no reason for Chapter 11 and no valid bankruptcy purpose, warranting dismissal of petition for lack of good faith; if a debtor has no need to rehabilitate or reorganize, its petition cannot serve the rehabilitative purpose for which Chapter 11 was designed. 11 U.S.C.A. § 1112(b).

1 Case that cites this headnote

[22] **Bankruptcy** Reorganization cases

To say that a debtor must be in financial distress to file a Chapter 11 petition is not to say it must necessarily be insolvent. 11 U.S.C.A. § 1112(b).

1 Case that cites this headnote

[23] **Bankruptcy** Good Faith; Motive

In evaluating motion to dismiss Chapter 11 petition as having not been filed in good faith, "good-faith gateway" asks whether the debtor faces the kinds of problems that justify Chapter 11 relief. 11 U.S.C.A. § 1112(b).

[24] **Bankruptcy** Reorganization cases

Bankruptcy Good Faith; Motive

Though insolvency is not strictly required for a Chapter 11 filing, and no list is exhaustive of all factors which could be relevant when analyzing a particular debtor's good faith in filing for Chapter 11 relief, court cannot ignore that debtor's balance sheet insolvency or insufficient cash flows to pay liabilities, or future likelihood of these issues occurring, are likely always relevant. 11 U.S.C.A. § 1112(b).

1 Case that cites this headnote

[25] **Bankruptcy** Good Faith; Motive

In determining whether Chapter 11 petition was filed in good faith, court considers, on case-by-case basis, all relevant facts in light of the purposes of the Bankruptcy Code. 11 U.S.C.A. § 1112(b).

[26] **Bankruptcy** "Good faith."

In determining whether Chapter 11 petition was filed in good faith, financial distress of debtor must not only be apparent, but it must be immediate enough to justify the Chapter 11 filing. 11 U.S.C.A. § 1112(b).

5 Cases that cite this headnote

[27] **Bankruptcy** "Good faith."

Attenuated possibility, standing alone, that debtor may have to file for bankruptcy in the future does not establish "good faith" in filing Chapter 11 petition. 11 U.S.C.A. § 1112(b).

[28] **Bankruptcy** "Good faith."

For purposes of determining whether Chapter 11 petition was filed in good faith, in particular, whether debtor's financial distress was both apparent and immediate enough to justify a filing, the Bankruptcy Code contemplates the need for early access to bankruptcy relief to allow debtor to rehabilitate its business before it is faced with hopeless situation. 11 U.S.C.A. § 1112(b).

1 Case that cites this headnote

[29] **Bankruptcy** "Good faith."

In determining whether Chapter 11 petition was filed in good faith, a "financially troubled" debtor facing mass tort liability may require bankruptcy to enable a continuation of its business and to maintain access to the capital markets, even before it is insolvent. 11 U.S.C.A. § 1112(b).

[30] **Bankruptcy** "Good faith."

Bankruptcy Code's encouragement of early filing does not open the door to premature filing, for purposes of determining whether Chapter 11 petition was filed in good faith; though this may be a fine line in some cases, the bankruptcy system puts courts, vested with equitable powers, in the best position to draw it. 11 U.S.C.A. § 1112(b).

[31] **Bankruptcy** Good Faith; Motive

When financially troubled debtors seek a chance to remain in business through the filing of a Chapter 11 petition, the exercise of the considerable powers vested in a debtor by the Bankruptcy Code is justified. 11 U.S.C.A. § 1112(b).

[32] **Bankruptcy** In general; nature and purpose

Congress designed Chapter 11 to give those businesses teetering on the verge of a fatal financial plummet an opportunity to reorganize on solid ground and try again, not to give profitable enterprises an opportunity to evade contractual or other liability.

[33] **Bankruptcy** In general; nature and purpose

Chapter 11 of the Bankruptcy Code was meant to deal with the reorganization of a financially distressed enterprise.

[34] **Bankruptcy** "Good faith."

When financial distress is present, bankruptcy may be an appropriate forum for a debtor to address mass tort liability, for purposes of determining whether a Chapter 11 petition was filed in good faith. 11 U.S.C.A. § 1112(b).

3 Cases that cite this headnote

[35] **Bankruptcy** "Good faith."

Although mass tort liability may push a debtor to the brink, to measure the debtor's distance to it, for purposes of determining the debtor's good faith in filing a Chapter 11 petition, courts must always weigh not just the scope of liabilities the debtor faces, but also the capacity it has to meet them. 11 U.S.C.A. § 1112(b).

[36] **Bankruptcy** "Good faith."

In evaluating, under the totality of the facts and circumstances, the good faith of Chapter 11 debtor, an indirect subsidiary of manufacturer of talc-based astringent powder which, through corporate restructuring, had assumed responsibility for manufacturer's talc-related liabilities, the Court of Appeals would consider only the financial condition of debtor, not its pre-bankruptcy predecessor which, due to divisional merger under Texas law, no longer existed; only debtor was in bankruptcy and subject to its good-faith requirement, and so predecessor's financial condition was relevant only to the extent that it informed the court's view of the financial condition of debtor itself. 11 U.S.C.A. § 1112(b); Tex. Bus. Org. Code § 10.00 et seq.

[37] **Bankruptcy** Effect of state law in general

State-law property interests should generally be given same effect inside and outside bankruptcy.

[38] **Bankruptcy** Effect of state law in general

Unless some federal interest requires a different result, there is no reason why state-law property interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.

[39] **Bankruptcy** Application of state or federal law in general

General expectation of state law and of the Bankruptcy Code is that courts respect entity separateness absent compelling circumstances calling equity into play.

[40] **Bankruptcy** Construction and Operation

Bankruptcy Code is designed in important part to protect and distribute a debtor's assets to satisfy its liabilities.

[41] **Bankruptcy** "Good faith."

Chapter 11 debtor, an indirect subsidiary of manufacturer of talc-based astringent powder which, through corporate restructuring, had assumed responsibility for manufacturer's talc-related liabilities, was not in financial distress, and so did not file its petition in good faith, warranting dismissal; despite massive talc-related liabilities totaling $4.5 billion in five-plus years of litigation to date, funding support agreement gave debtor right to cause its corporate parent and another affiliate, both highly creditworthy counterparties, to pay it cash of $61.5 billion or more to satisfy talc-related costs and normal-course expenses, such that debtor was, on petition date, highly solvent with access to cash to meet comfortably its liabilities as they came due for the foreseeable future, and, in light of pre-bankruptcy litigation history, court could not assume that most talc claims would go to trial, given possibility of meaningful settlement or successful defense and dismissal. 11 U.S.C.A. § 1112(b).

[42] **Bankruptcy** "Bad faith."

It is not "bad faith" to seek to gain an advantage from declaring bankruptcy. 11 U.S.C.A. § 1112(b).

[43] **Bankruptcy** In General; Grounds in General

"Unusual circumstances" did not preclude dismissal of petition of Chapter 11 debtor, an indirect subsidiary of manufacturer of talc-based astringent powder which, through corporate restructuring, had assumed responsibility for manufacturer's talc-related liabilities, where, despite its massive talc-related liabilities, debtor was not in financial distress on the petition date, and thus it could not show its petition served a valid bankruptcy purpose and was filed in good faith; no "reasonable justification" validated the missing requirement of financial distress, and the Court of Appeals could not currently see how debtor's lack of financial distress could be overcome. 11 U.S.C.A. § 1112(b)(2).

2 Cases that cite this headnote

[44] **Bankruptcy** Reorganization cases

Given the ability of Chapter 11 of the Bankruptcy Code to redefine fundamental rights of third parties, only those facing financial distress can call on bankruptcy's tools to do so. 11 U.S.C.A. § 1112(b).

***90** Appeal from the United States Bankruptcy Court for the District of New Jersey (District Court No.: 21-bk-30589; 21-ap-03032), Bankruptcy Judge: Honorable Michael B. Kaplan

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Before AMBRO, RESTREPO, and FUENTES, Circuit Judges

OPINION OF THE COURT

AMBRO, Circuit Judge

***92** Johnson & Johnson Consumer Inc. ("Old Consumer"), a wholly owned subsidiary of Johnson & Johnson ("J&J"), sold healthcare products with iconic names branded on consumers' consciousness—Band-Aid, Tylenol, Aveeno, and Listerine, to list but a few. It also produced Johnson's Baby Powder, equally recognizable for well over a century as a skincare product. Its base was talc, a mineral mined and milled into a fine powder. Concerns that the talc contained traces of asbestos spawned in recent years a torrent of lawsuits against Old Consumer and J&J alleging Johnson's Baby Powder has caused ovarian cancer and mesothelioma. Some of those suits succeeded ***93** in verdicts, some failed (outright or on appeal), and others settled. But more followed into the tens of thousands.

With mounting payouts and litigation costs, Old Consumer, through a series of intercompany transactions primarily under Texas state law, split into two new entities: LTL Management LLC ("LTL"), holding principally Old Consumer's liabilities relating to talc litigation and a funding support agreement from LTL's corporate parents; and Johnson & Johnson Consumer Inc. ("New Consumer"), holding virtually all the productive business assets previously held by Old Consumer. J&J's stated goal was to isolate the talc liabilities in a new subsidiary so that entity could file for Chapter 11 without subjecting Old Consumer's entire operating enterprise to bankruptcy proceedings.

Two days later, LTL filed a petition for Chapter 11 relief in the Bankruptcy Court for the Western District of North Carolina. That Court, however, transferred the case to the Bankruptcy Court for the District of New Jersey.

Talc claimants there moved to dismiss LTL's bankruptcy case as not filed in good faith. The Bankruptcy Court, in two thorough opinions, denied those motions and extended the automatic stay of actions against LTL to hundreds of nondebtors that included J&J and New Consumer. Appeals followed and are consolidated before us.

[1] **[2]** We start, and stay, with good faith. Good intentions—such as to protect the J&J brand or comprehensively resolve litigation—do not suffice alone. What counts to access the Bankruptcy Code's safe harbor is to meet its intended purposes. Only a putative debtor in financial distress can do so. LTL was not. Thus we dismiss its petition.

I. BACKGROUND

A. J&J, Baby Powder, and Old Consumer

The story of LTL begins with its parent company, J&J. It is a global company and household brand well-known to the public for its wide range of products relating to health and well-being. Many are consumer staples, filling pharmacies, supermarkets, and medicine cabinets throughout the country and beyond.

One of these products was Johnson's Baby Powder, first sold by J&J in 1894. It became particularly popular, being used by or on hundreds of millions of people at all stages of life.

J&J has not always sold baby powder directly, though. In 1979, it transferred all assets associated with its Baby Products division, including Johnson's Baby Powder, to Johnson & Johnson Baby Products Company ("J&J Baby Products"), a wholly owned subsidiary (the "1979 Spin-Off"). A series of further intercompany transactions in ensuing decades ultimately transferred Johnson's Baby Powder to Old Consumer.

So since 1979 only Old Consumer and its predecessors, and not J&J, have directly sold Johnson's Baby Powder. LTL maintains that the 1979 Spin-Off included an agreement between J&J and J&J Baby Products that makes Old Consumer, as successor to the latter, responsible for indemnifying J&J for all past, present, and future liabilities stemming from Johnson's Baby Powder. Thus, according to LTL, Old Consumer was liable for all claims relating to Johnson's Baby Powder, either directly or indirectly through its responsibility to indemnify J&J.

B. Baby Powder Litigation

Talc triggered little litigation against J&J entities before 2010. There had been ***94** but a small number of isolated claims alleging the products caused harms such as talcosis (a lung disease caused by inhalation of talc dust or talc), mesothelioma (a cancer of organ membranes, typically in the lungs, associated with exposure to asbestos), and rashes. But trials in 2013 and 2016 resulted in jury verdicts for plaintiffs alleging Old Consumer's talc-based products caused ovarian cancer. Despite the first resulting in no monetary award, and the second being reversed on appeal, these trials ushered in a wave of lawsuits alleging Johnson's Baby Powder caused ovarian cancer and mesothelioma.[1] Governmental actions, including the U.S. Food and Drug Administration's finding of asbestos traces in a sample of Johnson's Baby Powder in 2019 and Health Canada's confirmation in 2021 of its 2018 finding of a significant association between exposure to talc and ovarian cancer, also heightened J&J's and Old Consumer's potential exposure.

With the door wide open, over 38,000 ovarian cancer actions (most consolidated in federal multidistrict litigation in New Jersey) and over 400 mesothelioma actions were pending against Old Consumer and J&J when LTL filed its Chapter 11 petition. Expectations were for the lawsuits to continue, with thousands more in decades to come. The magnitude of the award in one case also raised the stakes. There, a Missouri jury awarded $4.69 billion to 22 ovarian cancer plaintiffs, reduced on appeal to $2.24 billion to 20 plaintiffs who were not dismissed. *Ingham v. Johnson & Johnson*, 608 S.W.3d 663 (Mo. Ct. App. 2020), *cert. denied*, ––– U.S. ––––, 141 S. Ct. 2716, 210 L.Ed.2d 879 (2021).

Yet other trials reaching verdicts for plaintiffs were not so damaging to J&J entities. Since 2018, damages in all other monetary awards to plaintiffs that were not reversed averaged about $39.7 million per claim. Moreover, Old Consumer and J&J often succeeded at trial. According to LTL's expert, of 15 completed ovarian cancer trials, only *Ingham* resulted in a monetary award for the plaintiffs that was not reversed; and of 28 completed mesothelioma trials, fewer than half resulted in monetary awards for the plaintiffs that were not reversed (and many of those were on appeal at the time of LTL's bankruptcy filing). In addition, Old Consumer and J&J often avoided trial before bankruptcy, settling roughly 6,800 talc-related claims for just under $1 billion in total and successfully obtaining dismissals without payment of about 1,300 ovarian cancer, and over 250 mesothelioma, actions.

Undoubtedly, the talc litigation put financial pressure on Old Consumer. Before LTL's petition, it paid approximately $3.5 billion for talc-related verdicts and settlements. It also paid nearly $1 billion in defense costs, and the continuing run rate was between $10 million to $20 million per month. LTL's expert identified talc-related costs as a primary driver that caused the income before tax of J&J's Consumer Health business segment (for which Old Consumer was the primary operating company in the U.S.) to drop from a $2.1 billion profit in 2019 to a $1.1 billion loss in 2020.

Old Consumer also faced billions in contested indemnification obligations to its bankrupt talc supplier, Imerys Talc America, Inc. and affiliates (collectively “Imerys”), ***95** as well as parties who had owned certain of Imerys's talc mines. These remained after J&J's settlement proposal of about $4 billion to $5 billion in the Imerys bankruptcy case—which, per LTL, had been tentatively agreed by attorneys for talc plaintiffs—ultimately fell through by June 2021. An LTL representative testified that, if that proposal succeeded, it would have settled (subject to an opt-out) virtually all ovarian cancer claims in the multidistrict tort litigation and corresponding additional claims against J&J entities in the Imerys case. Old Consumer was also the target of both state and federal talc-related governmental complaints and investigations, as well as securities and shareholder actions, that could result in their own financial penalties and defense costs. LTL's expert opined, and the Bankruptcy Court accepted, that the total talc-related liabilities threatened Old Consumer's ability to make substantial talc-related payments from working capital or other readily marketable assets while funding its costs of operations (including marketing, distribution, research and development).

Still, Old Consumer was a highly valuable enterprise, estimated by LTL to be worth $61.5 billion (excluding future talc liabilities), with many profitable products and brands. And much of its pre-filing talc costs were attributable to the payment of one verdict, *Ingham*, a liability J&J described in public securities filings as “unique” and “not representative of other claims.” App. 2692-93. Further, while it allocated all talc-related payments to Old Consumer per the 1979 Spin-Off, J&J functionally made talc payments from its accounts and received an intercompany payable from Old Consumer in return. Addressing the scope of its litigation exposure in an October 2021 management representation letter to its auditors, J&J valued its and its subsidiaries' probable and reasonably estimable contingent loss for products liability litigation, including for talc, under Generally Accepted Accounting Principles (“GAAP”), at $2.4 billion for the next 24 months. [2] It also continued to stand by the safety of its talc products and deny liability relating to their use.

Consistent with their fiduciary duties, and likely spurred by the U.S. Supreme Court's denial of certiorari in *Ingham*, members of J&J's management explored ways to mitigate Old Consumer's exposure to talc litigation. In a July 2021 email with a ratings agency, J&J's treasurer described a potential restructuring that would capture all asbestos liability in a subsidiary to be put into bankruptcy.

C. Corporate Restructuring and Divisional Merger

[3] On October 12, 2021, Old Consumer moved forward with this plan, undergoing a corporate restructuring relying principally on a merger under Texas law. Counterintuitively, this type of merger involves “the division of a [Texas] entity into two or more new ... entities.” Tex. Bus. Orgs. Code Ann. § 1.002(55)(A); *see generally id.* §§ 10.001 *et seq.* When the original entity does not survive the merger, it allocates its property, liabilities, and obligations among the new entities according to a plan of merger and, on implementation, its separate existence ends. *Id.* §§ 10.003, 10.008(a)(1). Except as otherwise provided by law or contract, no entity created in the merger is “liable for the debt or other obligation” allocated to any other new entity. *Id.* § 10.008(a)(4). In simplified terms, ***96** the merger splits a legal entity into two, divides its assets and liabilities between the two new entities, and terminates the original entity. While some pejoratively refer to it as the first step in a “Texas Two-Step” when followed by a bankruptcy filing, we more benignly call it a “divisional merger.”

In our case, Old Consumer's restructuring was designed as a series of reorganizational steps with the divisional merger at center. [3] Ultimately, the restructuring created two new entities, LTL and New Consumer, and on its completion Old Consumer ceased to exist. It also featured the creation of a Funding Agreement, which had Old Consumer stand in momentarily as the payee, but ultimately (after some corporate maneuvers [4]) gave LTL rights to funding from New Consumer and J&J.

As the most important step, the merger allocated LTL responsibility for essentially all liabilities of Old Consumer tied to talc-related claims. [5] This meant, among other things, it would take the place of Old Consumer in current and future talc lawsuits and be responsible for their defense.

Old Consumer also transferred to LTL assets in the merger, including principally the former's contracts related to talc litigation, indemnity rights, its equity interests in Royalty A&M LLC ("Royalty A&M"), and about $6 million in cash. Carved out from Old Consumer and its affiliates just before the divisional merger, Royalty A&M owns a portfolio of royalty streams that derive from consumer brands and was valued by LTL at approximately $367.1 million.

Of the assets Old Consumer passed to LTL, most important were Old Consumer's rights as a payee under the Funding Agreement with J&J and New Consumer. On its transfer, that gave LTL, outside of bankruptcy, the ability to cause New Consumer and J&J, jointly and severally, to pay it cash up to the value of New Consumer for purposes of satisfying any talc-related costs as well as normal course expenses. In bankruptcy, the Agreement gave LTL the right to cause New Consumer and J&J, jointly and severally, to pay it cash in the same amount to satisfy its administrative costs and to fund a trust, created in a plan of reorganization, to address talc liability for the benefit of existing and future claimants. In either scenario, there were few conditions to funding ***97** and no repayment obligation. [6] The value of the payment right could not drop below a floor defined as the value of New Consumer measured as of the time of the divisional merger, estimated by LTL at $61.5 billion, and was subject to increase as the value of New Consumer increased after it. [7]

On the other side of the divisional-merger ledger, New Consumer received all assets and liabilities of Old Consumer not allocated to LTL. It thus held Old Consumer's productive business assets, including its valuable consumer products, and, critically, none of its talc-related liabilities (except those related to workers' compensation). After this, the organizational chart was reshuffled to make New Consumer the direct parent company of LTL.

When the ink dried, LTL—having received Old Consumer's talc liability, rights under the Funding Agreement, a royalties business, and cash—was prepared to fulfill its reason for being: a bankruptcy filing. Meanwhile, New Consumer began operating the business formerly held by Old Consumer and would essentially remain unaffected (save for its funding obligation) by any bankruptcy filing of LTL.

LTL became in bankruptcy talk the "bad company," and New Consumer became the "good company." This completed the first steps toward J&J's goal of "globally resolv[ing] talc-related claims through a chapter 11 reorganization without subjecting the entire Old [Consumer] enterprise to a bankruptcy proceeding." App. 450 (Decl. of John Kim 6).

D. LTL Bankruptcy Filing and Procedural History

On October 14, 2021, two days after the divisional merger, LTL filed a petition for Chapter 11 relief in the Bankruptcy Court for the Western District of North Carolina. It also sought (1) to extend the automatic stay afforded to it under the Bankruptcy Code to talc claims arising from Johnson's Baby Powder asserted against over six hundred nondebtors (the "Third-Party Claims"), including affiliates such as J&J and New Consumer, as well as insurers and third-party retailers (all nondebtors collectively the "Protected Parties"), or alternatively, (2) a preliminary injunction enjoining those claims. LTL's first-day filings described the bankruptcy as an effort to "equitably and permanently resolve all current and future talc-related claims against it through the consummation of a plan of reorganization that includes the establishment of a [funding] trust." App. 3799 (LTL's Compl. for Decl. and Inj. Relief 2); App. 316 (LTL's Info. Br. 1).

[4] A month later, the North Carolina Bankruptcy Court issued an order enjoining Third-Party Claims against the Protected Parties. But the order expired after 60 days and would not bind a subsequent court. The next day, following motions from interested parties (including representatives for talc claimants) and a Show Cause Order, the Court transferred LTL's Chapter 11 case to the District of New Jersey under 28 U.S.C. § 1412. It rejected what it viewed as LTL's effort to "manufacture ***98** venue" and held that a preference to be subject to the Fourth Circuit's two-prong bankruptcy dismissal standard [8] could not justify its filing in North Carolina. App. 1515 (N.C. Transfer Order 10).

With the case pending in the Bankruptcy Court for the District of New Jersey, the Official Committee of Talc Claimants (the "Talc Claimants' Committee") moved to dismiss LTL's petition under § 1112(b) of the Bankruptcy Code as not filed in good faith. Soon after, Arnold & Itkin LLP, on behalf of talc claimants it represented ("A&I"), also moved for dismissal on the same basis. LTL opposed the motions. Two other law firms—including Aylstock, Witkin, Kreis & Overholtz, PLLC, on behalf of talc claimants ("AWKO")—joined the motions. For ease of reference, we refer collectively to the Talc Claimants' Committee, A&I, and AWKO as the "Talc Claimants."

At the same time, LTL urged the New Jersey Bankruptcy Court to extend the soon-to-expire order enjoining Third-Party Claims against the Protected Parties. The Talc Claimants' Committee and AWKO opposed this motion.

In February 2022, the Bankruptcy Court held a five-day trial on the motions to dismiss and LTL's third-party injunction motion. It denied soon thereafter the motions to dismiss and granted the injunction motion. App. 1, 57, 140, 194 (Mot. to Dismiss Op.; Mot. to Dismiss Order; Third-Party Inj. Op.; Third-Party Inj. Order).

[5] In its opinion addressing the motions to dismiss, the Bankruptcy Court applied Third Circuit case law and held that LTL filed its bankruptcy petition in good faith. The Court ruled the filing served a valid bankruptcy purpose because it sought to resolve talc liability by creating a trust for the benefit of claimants under § 524(g) of the Bankruptcy Code. At a high level, that provision allows a debtor satisfying certain conditions to establish, in a plan of reorganization, a trust for the benefit of current and future claimants against which an injunction channels all asbestos litigation.[9] The Court highlighted what it viewed as several benefits of claims administration through a § 524(g) trust, compared to mass asbestos litigation in trial courts, including the possibility it could resolve claims more efficiently (from both a cost and time perspective), ensure more balanced recoveries among claimants, and preserve funds for future claimants.

The Court also held LTL was in financial distress. It focused on the scope of litigation faced by Old Consumer (and transferred to LTL), the historic costs incurred by Old Consumer in connection with talc litigation, and the effect of these ***99** costs on its business. It suggested that extrapolating this talc liability into the future showed the "continued viability of all J&J companies [was] imperiled." App. 36 (Mot. to Dismiss Op. 36). Yet it appeared to doubt LTL would completely exhaust its payment right under the Funding Agreement. App. 35 (*Id.* at 35).

Finally, the Court determined LTL's corporate restructuring and bankruptcy were not undertaken to secure an unfair tactical litigation advantage against talc claimants, but constituted "a single integrated transaction" that did not prejudice creditors and eliminated costs that would otherwise be imposed on Old Consumer's operating business had it been subject to bankruptcy. App. 43 (*Id.* at 43). The Court ultimately saw the bankruptcy forum as having a superior ability, compared to trial courts, to protect the talc claimants' interests, viewing this as an "unusual circumstance[ ]" that precluded dismissal under 11 U.S.C. § 1112(b)(2). App. 13 (*Id.* at 13 n.8).

At the same time the Bankruptcy Court grappled substantively with existing Circuit case law, it made much of LTL's novel design and the reasons for it. Its bankruptcy, the Court believed, presented a "far more significant issue" than equitable limitations on bankruptcy filings: "which judicial system [better served talc claimants]—the state/federal court trial system, or a trust vehicle established under a chapter 11 reorganization plan ... [in Bankruptcy Court]." App. 12-13 (*Id.* at 12-13). Answering this question, it provided a full defense of its "strong conviction that the bankruptcy court is the optimal venue for redressing the harms of both present and future talc claimants in this case." App. 19 (*Id.* at 19).[10]

The Talc Claimants timely appealed the Bankruptcy Court's order denying the motions to dismiss. The Talc Claimants' Committee and AWKO also appealed the order enjoining Third-Party Claims against the Protected Parties. On request of the Talc Claimants, the Bankruptcy Court certified the challenged orders to our Court under 28 U.S.C. § 158(d)(2). In May 2022, we authorized direct appeal of the orders under the same statute.

The Bankruptcy Court had jurisdiction of the bankruptcy case under, *inter alia*, 28 U.S.C. §§ 157(a) and 1334(a).[11] We have jurisdiction of the appeals under 28 U.S.C. § 158(d)(2)(A).

II. ANALYSIS

A. Standard of Review

[6] **[7]** We review for an abuse of discretion the Bankruptcy Court's denial of the motions to dismiss the Chapter 11 petition for lack of good faith. *In re 15375 Mem'l Corp. v. BEPCO, L.P.*, 589 F.3d 605, 616 (3d Cir. 2009). That exists when the decision "rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact." *Id.* (citation omitted). We give fresh (*i.e.*, plenary or *de novo*) review to a conclusion of law and review for clear error findings of fact leading to the decision. *Id.*

***100 [8] [9]** Facts subject to clear-error review include those that are basic, "the historical and narrative events elicited from the evidence presented at trial ...," and those that are inferred, which are "drawn from basic facts and are permitted only when, and to the extent that, logic and human experience indicate a probability that certain consequences can and do follow from the basic facts." *Universal Mins., Inc. v. C.A. Hughes & Co.*, 669 F.2d 98, 102 (3d Cir. 1981). These are distinguished from an "ultimate fact," which is a "legal concept with a factual component." *Id.* at 103. Examples include negligence or reasonableness. *Wells Fargo, N.A. v. Bear Stearns & Co. (In re HomeBanc Mortg. Corp.)*, 945 F.3d 801, 810 (3d Cir. 2019). Reviewing an ultimate fact, "we separate [its] distinct factual and legal elements ... and apply the appropriate standard to each component." *Universal Mins.*, 669 F.2d at 103.

[10] [11] Concluding a bankruptcy petition is filed in good faith is an "ultimate fact." *BEPCO*, 589 F.3d at 616. While the underlying basic and inferred facts require clear-error review, the culminating determination of whether those facts support a conclusion of good faith gets plenary review as "essentially[ ] a conclusion of law." *Id.*; *see also U.S. Bank Nat'l Ass'n ex. rel. CWCapital Asset Mgmt. LLC v. Vill. at Lakeridge, LLC*, ––– U.S. ––––, 138 S. Ct. 960, 966-68, 200 L.Ed.2d 218 (2018). A conclusion of financial distress, like the broader good-faith inquiry of which it is a part, likewise is subject to mixed review. Whether financial distress exists depends on the underlying basic facts, such as the debtor's ability to pay its current debts, and inferred facts, such as projections of how much pending and future liabilities (like litigation) could cost it in the future. But the ultimate determination, like with good faith, is essentially a conclusion of law that gets a fresh look. *See id.*

B. Good Faith

[12] [13] [14] Chapter 11 bankruptcy petitions are "subject to dismissal under 11 U.S.C. § 1112(b) unless filed in good faith." *BEPCO*, 589 F.3d at 618 (citing *NMSBPCSLDHB, L.P. v. Integrated Telecom Express, Inc. (In re Integrated Telecom Express, Inc.)*, 384 F.3d 108, 118 (3d Cir. 2004)). Section 1112(b) provides for dismissal for "cause." A lack of good faith constitutes "cause," though it does not fall into one of the examples of cause specifically listed in the statute. *See In re SGL Carbon Corp.*, 200 F.3d 154, 159-62 (3d Cir. 1999). Because the Code's text neither sets nor bars explicitly a good-faith requirement, we have grounded it in the "equitable nature of bankruptcy" and the "purposes underlying Chapter 11." *Id.* at 161-62 ("A debtor who attempts to garner shelter under the Bankruptcy Code ... must act in conformity with the Code's underlying principles.").

[15] [16] [17] Once at issue, the burden to establish good faith is on the debtor. *BEPCO*, 589 F.3d at 618 (citing *Integrated Telecom*, 384 F.3d at 118); *SGL Carbon*, 200 F.3d at 162 n.10. We "examine the totality of facts and circumstances and determine where a petition falls along the spectrum ranging from the clearly acceptable to the patently abusive." *BEPCO*, 589 F.3d at 618 (internal quotation marks omitted) (citing *Integrated Telecom*, 384 F.3d at 118). Though a debtor's subjective intent may be relevant, good faith falls "more on [an] objective analysis of whether the debtor has sought to step outside the 'equitable limitations' of Chapter 11." *Id.* at 618 n.8 (citing *SGL Carbon*, 200 F.3d at 165).

[18] [19] [20] "[T]wo inquiries ... are particularly relevant": "(1) whether the petition ***101** serves a valid bankruptcy purpose[;] and (2) whether [it] is filed merely to obtain a tactical litigation advantage." *Id.* at 618 (internal quotation marks omitted) (citing *Integrated Telecom*, 384 F.3d at 119-20). Valid bankruptcy purposes include "preserv[ing] a going concern" or "maximiz[ing] the value of the debtor's estate." *Id.* at 619. Further, a valid bankruptcy purpose "assumes a debtor in financial distress." *Integrated Telecom*, 384 F.3d at 128.

C. Financial Distress as a Requirement of Good Faith

[21] Our precedents show a debtor who does not suffer from financial distress cannot demonstrate its Chapter 11 petition serves a valid bankruptcy purpose supporting good faith. We first applied this principle in *SGL Carbon.* The debtor there filed for Chapter 11 protection in the face of many antitrust lawsuits—in its words, to "protect itself against excessive demands made by plaintiffs" and "achieve an expeditious resolution of the claims." 200 F.3d at 157. But we dismissed the petition for lack of good faith, relying on the debtor's strong financial health. *Id.* at 162-70. We rejected arguments that the suits seriously threatened the company and could force it out of business, suggesting the magnitude of potential liability would not likely render it insolvent. *Id.* at 162-64.

And the filing was premature, as one could be later made—without risking the debtor's ability to reorganize—at a time a company-threatening judgment occurred. *Id.* at 163. Finally, in considering whether the petition served a valid bankruptcy purpose, we discerned none in light of the debtor's substantial equity cushion and a lack of evidence suggesting it had trouble paying debts or impaired access to capital markets. *Id.* at 166. Were the debtor facing "serious financial and/or managerial difficulties at the time of filing," the result may have been different. *Id.* at 164.

Integrated Telecom made clear that "good faith *necessarily requires* some degree of financial distress on the part of a debtor." 384 F.3d at 121 (emphasis added). That debtor was a non-operating, nearly liquidated shell company that was "highly solvent and cash rich at the time of the bankruptcy." *Id.* at 124. And its financial condition was key to the petition's dismissal. We said that Chapter 11 could not improve its failing business model nor resolve pending securities litigation in a way that increased recoveries for creditors. *Id.* at 120-26. Thus the proceeding could preserve no "value that otherwise would be lost outside of bankruptcy," showing those problems were not the kinds of financial issues Chapter 11 aimed to address. *Id.* at 120, 129. And absent financial distress, the debtor's desire to benefit from certain Code provisions (such as those capping claims for future rents) could not justify its presence in bankruptcy. *Id.* at 126-29.

We note that, when considering the whole of the circumstances in these decisions, we evaluated rationales for filing offered by the debtor that were only modestly related to its financial health—even after recognizing it was not in financial distress. Yet we rejected all of them and stuck to the debtor's financial condition. *Id.*; *SGL Carbon*, 200 F.3d at 167-68.

The theme is clear: absent financial distress, there is no reason for Chapter 11 and no valid bankruptcy purpose. "Courts, therefore, have consistently dismissed ... petitions filed by financially healthy companies with no need to reorganize under the protection of Chapter 11.... [I]f a petitioner has no need to rehabilitate or reorganize, its petition cannot serve the rehabilitative purpose for which Chapter 11 was designed." ***102** *Integrated Telecom*, 384 F.3d at 122 (quoting *SGL Carbon*, 200 F.3d at 166).

[22] But what degree of financial distress justifies a debtor's filing? To say, for example, that a debtor must be in financial distress is not to say it must necessarily be insolvent. We recognize as much, as the Code conspicuously does not contain any particular insolvency requirement. *See SGL Carbon*, 200 F.3d at 163; *Integrated Telecom*, 384 F.3d at 121. And we need not set out any specific test to apply rigidly when evaluating financial distress. Nor does the Code direct us to apply one.

[23] **[24]** Instead, the good-faith gateway asks whether the debtor faces the kinds of problems that justify Chapter 11 relief. Though insolvency is not strictly required, and "no list is exhaustive of all the factors which could be relevant when analyzing a particular debtor's good faith," *SGL Carbon*, 200 F.3d at 166 n.16, we cannot ignore that a debtor's balance-sheet insolvency or insufficient cash flows to pay liabilities (or the future likelihood of these issues occurring) are likely always relevant. This is because they pose a problem Chapter 11 is designed to address: "that the system of individual creditor remedies may be bad for the creditors *as a group* when there are *not enough assets to go around.*" *Integrated Telecom*, 384 F.3d at 121 (second set of italics added) (quoting Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* 10 (1986)).

[25] Still, we cannot today predict all forms of financial difficulties that may in some cases justify a debtor's presence in Chapter 11. Financial health can be threatened in other ways; for instance, uncertain and unliquidated future liabilities could pose an obstacle to a debtor efficiently obtaining financing and investment. As we acknowledged in *SGL Carbon*, certain financial problems or litigation may require significant attention, resulting in "serious ... managerial difficulties." 200 F.3d at 164. Mass tort cases may present these issues and others as well, like the exodus of customers and suppliers wary of a firm's credit-risk. *See, e.g.*, Mark J. Roe, *Bankruptcy and Mass Tort*, 84 Colum. L. Rev. 846, 855 (1984) (describing the "adverse" and "severe" effects large-scale, future tort claims may have on a firm). So many spokes can lead to financial distress in the right circumstances that we cannot divine them all. What we can do, case-by-case, is consider all relevant facts in light of the purposes of the Code.

[26] **[27]** **[28]** **[29]** Financial distress must not only be apparent, but it must be immediate enough to justify a filing. "[A]n attenuated possibility standing alone" that a debtor "may have to file for bankruptcy in the future" does not establish good faith. *SGL Carbon*, 200 F.3d at 164; *see, e.g., Baker v. Latham Sparrowbush Assocs. (In re Cohoes Indus. Terminal, Inc.)*, 931 F.2d 222, 228 (2d Cir. 1991) ("Although a debtor need not be *in extremis* in order to file[,] ... it must, at least, face such financial difficulty that, if it did not file at that time, it could anticipate the need to file in the future."). Yet we recognize the Code contemplates "the need for early access to bankruptcy relief to allow a debtor to rehabilitate its business before it is faced with a hopeless situation." *SGL Carbon*, 200 F.3d at 163. A "financially troubled" debtor facing mass tort liability, for example, may require bankruptcy to "enable a continuation of [its] business and to maintain access to the capital markets" even before it is insolvent. *Id.* at 169.

[30] Still, encouragement of early filing "does not open the door to premature filing." *Id.* at 163. This may be a fine line in some cases, but our bankruptcy system puts courts, vested with equitable powers, in the best position to draw it.

***103** Risks associated with premature filing may be particularly relevant in the context of a mass tort bankruptcy. Inevitably those cases will involve a bankruptcy court estimating claims on a great scale—introducing the possibility of undervaluing future claims (and underfunding assets left to satisfy them) [12] and the difficulty of fairly compensating claimants with wide-ranging degrees of exposure and injury. On the other hand, a longer history of litigation outside of bankruptcy may provide a court with better guideposts when tackling these issues. [13]

[31] **[32]** To take a step back, testing the nature and immediacy of a debtor's financial troubles, and examining its good faith more generally, are necessary because bankruptcy significantly disrupts creditors' existing claims against the debtor: "Chapter 11 vests petitioners with considerable powers—the automatic stay, the exclusive right to propose a reorganization plan, the discharge of debts, etc.—that can impose significant hardship on particular creditors. When *financially troubled* petitioners seek a chance to remain in business, the exercise of those powers is justified." *Integrated Telecom*, 384 F.3d at 120 (emphasis added) (citing *SGL Carbon*, 200 F.3d at 165-66). Accordingly, we have said the availability of certain debtor-favored Code provisions "assume[s] the existence of a valid bankruptcy, which, in turn, assumes a debtor in financial distress." *Id.* at 128. Put another way, "Congress designed Chapter 11 to give those businesses teetering on the verge of a fatal financial plummet an opportunity to reorganize on solid ground and try again, not to give profitable enterprises an opportunity to evade contractual or other liability." *Cedar Shore Resort, Inc v. Mueller (In re Cedar Shore Resort, Inc.)*, 235 F.3d 375, 381 (8th Cir. 2000) (internal quotation marks omitted).

[33] Our confidence in the conclusion that financial distress is vital to good faith is reinforced by the central role it plays in other courts' inquiries. [14] Chapter 11's legislative ***104** history also suggests it was meant to "deal[ ] with the reorganization of a financially distressed enterprise." *SGL Carbon*, 200 F.3d at 166 (quoting S. Rep. No. 95-989, at 9, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5795).

[34] The takeaway here is that when financial distress is present, bankruptcy may be an appropriate forum for a debtor to address mass tort liability. Our *SGL Carbon* decision specifically addressed this in distinguishing the financial distress faced by Johns-Manville in its Chapter 11 case. It was prompted by a tide of asbestos litigation that, but for its filing, would have forced the debtor to book a $1.9 billion liability reserve "trigger[ing] the acceleration of approximately $450 million of outstanding debt, [and] possibly resulting in a forced liquidation of key business segments." *In re Johns-Manville Corp.*, 36 B.R. 727, 730 (Bankr. S.D.N.Y. 1984). That created a "compelling need [for the debtor] to reorganize in order to meet" its obligations to creditors. *Id.* This urgency stood in stark contrast to the circumstances in *SGL Carbon*, where the debtor faced no suits, or even liquidated judgments, that threatened its ongoing operations.

A.H. Robins Company, before its bankruptcy, faced financial woes like Johns-Manville's, in both cases caused by mass product liabilities litigation. Before filing, Robins had only $5 million in unrestricted funds and a "financial picture ... so bleak that financial institutions were unwilling to lend it money." *In re A.H. Robins Co., Inc.*, 89 B.R. 555, 558 (Bankr. E.D.V.A. 1988). The Court concluded Robins "had no choice but to file for relief under Chapter 11." *Id.*

And in Dow Corning's Chapter 11 case, the Court described the company's resolve to address mass tort liability as "a legitimate effort to rehabilitate a solvent but *financially-distressed* corporation." *In re Dow Corning Corp.*, 244 B.R. 673, 676-77 (Bankr. E.D. Mich. 1999) (emphasis added). It specifically recognized that "the legal costs and logistics of defending the worldwide product liability lawsuits against the [d]ebtor threatened its vitality by depleting its financial resources and preventing its management from focusing on core business matters." *Id.* at 677.

[35] These cases show that mass tort liability can push a debtor to the brink. But to measure the debtor's distance to it, courts must always weigh not just the scope of liabilities the debtor faces, but also the capacity it has to meet them. We now go there, but only after detouring to a problem particular to our case: For good-faith purposes, should we judge the financial condition of LTL by looking to Old Consumer—the operating business with valuable assets, but damaging tort liability, that the restructuring and filing here aimed to protect? Or should we look to LTL, the entity that actually filed for bankruptcy? Or finally, like the Bankruptcy Court, should we consider "the financial risks and burdens facing both Old [Consumer] and [LTL]"? App. 14 (Mot. to Dismiss Op. 14).

*105 D. Only LTL's Financial Condition is Determinative.

[36] Weighing the totality of facts and circumstances might seem on the surface to require that we evaluate the state of affairs of both Old Consumer and LTL when judging the latter's financial distress. That said, we must not underappreciate the financial reality of LTL while unduly elevating the comparative relevance of its pre-bankruptcy predecessor that no longer exists. Even were we unable to distinguish the financial burdens facing the two entities, we can distinguish their vastly different sets of available assets to address those burdens. On this we part from the Bankruptcy Court.

Thus for us, the financial state of LTL—a North Carolina limited liability company formed under state law and existing separate from both its predecessor company (Old Consumer) and its newly incorporated counterpart company (New Consumer)—should be tested independent of any other entity. That means we focus on its assets, liabilities, and, critically, the funding backstop it has in place to pay those liabilities.

[37] **[38]** Doing so reflects the principle that state-law property interests should generally be given the same effect inside and outside bankruptcy: "Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Butner v. United States*, 440 U.S. 48, 55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979). No one doubts that the state-law divisional merger passed talc liabilities to LTL. Why in bankruptcy would we recognize the effectiveness of this state-law transaction, but at the same time ignore others that augment LTL's assets, such as its birth gift of the Funding Agreement? To say the financial condition of Old Consumer prior to the restructuring—which was not bolstered by such a contractual payment right—determines the availability of Chapter 11 to LTL would impose on the latter a lookback focused on the nonavailability of a funding backstop to what is now a nonentity.

Instead, we must evaluate the full set of state-law transactions involving LTL to understand the makeup of its financial rights and obligations that, in turn, dictate its financial condition. Even were we to agree that the full suite of reorganizational steps was a "single integrated transaction," App. 43 (Mot. to Dismiss Op. 43), this conclusion does not give us license to look past its effect: the creation of a new entity with a unique set of assets and liabilities, and the elimination of another. Only the former is in bankruptcy and subject to its good-faith requirement. *See* Ralph Brubaker, *Assessing the Legitimacy of the "Texas Two-Step" Mass-Tort Bankruptcy*, 42 No. 8 Bankr. L. Letter NL 1 (Aug. 2022) (observing that the Bankruptcy Code is designed to address the financial distress of the entity *in* bankruptcy).

[39] We cannot say a "federal interest requires a different result." *See Butner*, 440 U.S. at 55, 99 S.Ct. 914. That is because the Bankruptcy Code is an amalgam of creditor-debtor tradeoffs balanced by a Congress that assumed courts applying it would respect the separateness of legal entities (and their respective assets and liabilities). "[T]he general expectation of state law and of the Bankruptcy Code ... is that courts respect entity separateness absent compelling circumstances calling equity ... into play." *In re Owens Corning*, 419 F.3d 195, 211 (3d Cir. 2005). Put differently, as separateness is foundational to corporate law, which in turn is a predicate to bankruptcy law, it is not easily ignored. It is especially hard to ignore ***106** when J&J's pre-bankruptcy restructuring—ring-fencing talc liabilities in LTL and forming the basis for this filing—depended on courts honoring this principle.

[40] The Bankruptcy Code is designed in important part to protect and distribute a debtor's assets to satisfy its liabilities. It strains logic then to say the condition of a defunct entity should determine the availability of Chapter 11 to the only entity subject to it. To do so would introduce uncertainty regarding how far back and to what entities a court can look when evaluating a debtor's financial distress.

Thus, while we agree with the Bankruptcy Court that both entities are part of our discussion of financial distress, the financial condition of Old Consumer is relevant only to the extent it informs our view of the financial condition of LTL itself.

E. LTL Was Not in Financial Distress.

[41] With our focus properly set, we now evaluate the financial condition of LTL. It is here we most disagree with the Bankruptcy Court, as it erred by overemphasizing the relevance of Old Consumer's financial condition. And while we do not second-guess its findings on the scope and costs of talc exposure up to the filing date, we do not accept its projections of future liability derived from those facts.

After these course corrections, we cannot agree LTL was in financial distress when it filed its Chapter 11 petition. The value and quality of its assets, which include a roughly $61.5 billion payment right against J&J and New Consumer, make this holding untenable.

The Funding Agreement merits special mention. To recap, under it LTL had the right, outside of bankruptcy, to cause J&J and New Consumer, jointly and severally, to pay it cash up to the value of New Consumer as of the petition date (estimated at $61.5 billion) to satisfy any talc-related costs and normal course expenses. Plus this value would increase as the value of New Consumer's business and assets increased. App. 4316-17 (Funding Agreement 4-5, § 1 Definition of "JJCI Value"). [15] The Agreement provided LTL a right to cash that was very valuable, likely to grow, and minimally conditional. And this right was reliable, as J&J and New Consumer were highly creditworthy counterparties (an understatement) with the capacity to satisfy it.

As for New Consumer, it had access to Old Consumer's cash-flowing brands and products along with the profits they produced, which underpinned the $61.5 billion enterprise value of New Consumer as of LTL's filing. And the sales and adjusted income of the consumer health business showed steady growth in the last several years when talc costs were excluded. Most important, though, the payment right gave LTL direct access to J&J's exceptionally strong balance sheet. At the time of LTL's filing, J&J had well over $400 billion in equity value with a AAA credit rating and $31 billion just in cash and marketable securities. It distributed over $13 billion to shareholders in each of 2020 and 2021. It is hard to imagine a scenario where J&J and New Consumer would be unable to satisfy their joint obligations under the Funding Agreement. And, of course, J&J's primary, contractual obligation to fund talc costs was one never owed to Old Consumer (save for the short moment during the ***107** restructuring that it was technically a party to the Funding Agreement).

Yet the Bankruptcy Court hardly considered the value of LTL's payment right to its financial condition. True, it noted its jurisdictional authority could "ensure that [LTL] pursue[d] its available rights" under the Funding Agreement. App. 43 (Mot. to Dismiss Op. 43). But, in discussing LTL's financial condition, the Court was "at a loss to understand, why—merely because [LTL] contractually has the right to exhaust its funding options [under the Funding Agreement]"—it was "not to be regarded as being in 'financial distress.' " App. 35 (*Id.* at 35). It speculated that a draw on the payment right could force J&J to deplete its available cash or pursue a forced liquidation of New Consumer and have a "horrific impact" on those companies. *Id.* The assumption seems to be that, out of concern for its affiliates, LTL may avoid drawing on the payment right to its full amount. But this is unsupported and disregards the duty of LTL to access its payment assets.

Ultimately, whether this assumption was made or not, the Bankruptcy Court did not consider the full value of LTL's backstop when judging its financial condition. And at the same time it acutely focused on how talc litigation affected *Old Consumer. See, e.g.*, App. 34 (Mot. to Dismiss Op. 34) ("The evidence confirms that the talc litigation ... forced *Old [Consumer]* into a loss position in 2020"); App. 36 (*Id.* at 36) ("*Old [Consumer]* was not positioned to continue making substantial [t]alc [l]itigation payments"); App. 38 (*Id.* at 38) ("*Old [Consumer]* need not have waited until its viable business operations were threatened past the breaking point") (emphasis added in each citation). Directing its sight to Old Consumer and away from the Funding Agreement's benefit to LTL essentially made the financial means of Old Consumer, and not LTL, the lodestar of the Court's financial-distress analysis. This misdirection was legal error.

We also find a variable missing in the Bankruptcy Court's projections of future liability for LTL extrapolated from the history of Old Consumer's talc litigation: the latter's successes. To reiterate, before bankruptcy Old Consumer had settled about 6,800 talc-related claims for under $1 billion and obtained dismissals of about 1,300 ovarian cancer and over 250 mesothelioma claims without payment. And a minority of the completed trials resulted in verdicts against it (with some of those verdicts reversed on appeal). Yet the Court invoked calculations that just the legal fees to defend all existing ovarian cancer claims (each through trial) would cost up to $190 billion. App. 37 (*Id.* at 37). It surmised "one could argue" the exposure from the existing mesothelioma claims alone exceeded $15 billion. App. 17 (*Id.* at 17). These conjectures ballooned its conclusion that, "[e]ven without a calculator or abacus, one can multiply multi-million dollar or multi-billion dollar verdicts by tens of thousands of existing claims, let alone future claims," to see that "the continued viability of all J&J companies is imperiled." App. 36 (*Id.* at 36).

What these projections ignore is the possibility of meaningful settlement, as well as successful defense and dismissal, of claims by assuming most, if not all, would go to and succeed at trial. In doing so, these projections contradict the record. And while the Bankruptcy Court questioned the continuing relevance of the past track record after *Ingham* and the breakdown of the Imerys settlement talks, this assumes too much too early. Nothing in the record suggests *Ingham*—one of 49 pre-bankruptcy trials and described even by J&J as "unique" and "not representative," App. 2692-93—was the new norm. ***108** Nor is there anything that shows all hope of a meaningful global or near-global settlement was lost after the initial Imerys offer was rebuffed. The Imerys bankruptcy remained a platform to negotiate settlement. And the progression of the multidistrict litigation on a separate track would continue to sharpen all interested parties' views of mutually beneficial settlement values.

Finally, we cannot help noting that the casualness of the calculations supporting the Court's projections engenders doubt as to whether they were factual findings at all, but instead back-of-the-envelope forecasts of hypothetical worst-case scenarios. Still, to the extent they were findings of fact, we cannot say these were inferences permissibly drawn and entitled to deference. *See Universal Mins.*, 669 F.2d at 102. Hence, they were clearly erroneous. And as we locate no other inferences or support in the record to bear the Court's assertion that the "talc liabilities" "far exceed [LTL's] capacity to satisfy [them]," we cannot accept this conclusion either. [16] App. 23 (Mot. to Dismiss Op. 23).

In this context, it becomes clear that, on its filing, LTL did not have any likely need in the present or the near-term, or even in the long-term, to exhaust its funding rights to pay talc liabilities. In the over five years of litigation to date, the aggregate costs had reached $4.5 billion (less than 7.5% of the $61.5 billion value on the petition date), with about half of these costs attributable to one ovarian cancer verdict, *Ingham*, to date an outlier victory for plaintiffs. While the number of talc claims had surged in recent years, still J&J, as of October 2021, valued the probable and reasonably estimable contingent loss for its products liability litigation, including for talc, under GAAP, at $2.4 billion for the next two years. Further, though settlement offers are only that, we do not disregard LTL's suggestion that $4 billion to $5 billion was at one time considered by plaintiffs' lawyers to be in the ballpark to resolve virtually all multidistrict ovarian cancer claims as well as corresponding additional claims in the Imerys bankruptcy. And as noted, we view all this against a pre-bankruptcy backdrop where Old Consumer had success settling claims or obtaining dismissal orders, and where, at trial, ovarian cancer plaintiffs never won verdicts that withstood appeal outside of *Ingham* and mesothelioma plaintiffs had odds of prevailing that were less than stellar.

From these facts—presented by J&J and LTL themselves—we can infer only that LTL, at the time of its filing, was highly solvent with access to cash to meet comfortably its liabilities as they came due for the foreseeable future. It looks correct to have implied, in a prior court filing, that there was not "*any imminent or even* ***109** *likely need of [it] to invoke the Funding Agreement to its maximum amount or anything close to it.*" App. 3747 (LTL's Obj. to Mots. for Cert. of Direct Appeal 22) (emphasis added). Indeed, the Funding Agreement itself recited that LTL, after the divisional merger and assumption of that Agreement, held "assets having a value at least equal to its liabilities and had financial capacity sufficient to satisfy its obligations as they become due in the ordinary course of business, *including any [t]alc [r]elated [l]iabilities.*" App. 4313 (Funding Agreement 1, ¶ E) (emphasis added). This all comports with the theme LTL proclaimed in this case from day one: it can pay current and future talc claimants in full. *See* App. 630 (Transcript of N.C. "First Day" Hearing, October 20, 2021) (LTL's counsel telling the North Carolina bankruptcy court in his opening remarks that "[LTL], New [Consumer], and J&J believe that $2 billion exceeds any liability [LTL] could reasonably have for talc-related claims ...." (emphasis added)).

We take J&J and LTL at their word and agree. LTL has a funding backstop, not unlike an ATM disguised as a contract, that it can draw on to pay liabilities without any disruption to its business or threat to its financial viability. It may be that a draw under the Funding Agreement results in payments by New Consumer that in theory might someday threaten its ability to sustain its operational costs. But those risks do not affect LTL, for J&J remains its ultimate safeguard. And we cannot say any potential liquidation by LTL of Royalty A&M

—a collection of bare rights to streams of payments cobbled together on the eve of bankruptcy—to pay talc costs would amount to financial distress. Plus LTL had no obligation, outside of bankruptcy, to sell those assets for cash before drawing on the Funding Agreement.

At base level, LTL, whose employees are all J&J employees, is essentially a shell company "formed," almost exclusively, "to manage and defend thousands of talc-related claims" while insulating at least the assets now in New Consumer. App. 449 (Decl. of John Kim 5). And LTL was well-funded to do this. As of the time of its filing, we cannot say there was any sign on the horizon it would be anything but successful in the enterprise. It is even more difficult to say it faced any "serious financial and/or managerial difficulties" calling for the need to reorganize during its short life outside of bankruptcy. *SGL Carbon*, 200 F.3d at 164. [17]

But what if, contrary to J&J's statements, *Ingham* is not an anomaly but a harbinger of things to come? What if time shows, with the progression of litigation outside of bankruptcy, that cash available under the Funding Agreement cannot adequately address talc liability? Perhaps at that time LTL could show it belonged in bankruptcy. But it could not do so in October 2021. While LTL inherited massive liabilities, its call on assets to fund them exceeded any reasonable projections available on the record before us. The "attenuated possibility" that talc litigation may require it to file for bankruptcy in the future does not establish its good faith as of its petition date. *Id.* at 164. At best the filing was premature. [18]

***110** **[42]** In sum, while it is unwise today to attempt a tidy definition of financial distress justifying in all cases resort to Chapter 11, we can confidently say the circumstances here fall outside those bounds. Because LTL was not in financial distress, it cannot show its petition served a valid bankruptcy purpose and was filed in good faith under Code § 1112(b). [19]

F. "Unusual Circumstances" Do Not Preclude Dismissal

[43] The Bankruptcy Court held, as an independent basis for its decision, that even if LTL's petition were not filed in good faith, § 1112(b)(2) of the Code authorized it nonetheless to deny dismissal. For a petition to be saved under that provision, a court must identify "unusual circumstances establishing that ... [dismissal] is not in the best interests of creditors and the estate." 11 U.S.C. § 1112(b)(2). The debtor (or any other party in interest) must also establish "the grounds for ... [dismissal] include an act or omission" (1) "for which there exists a reasonable justification" and (2) "that will be cured within a reasonable period of time." *Id.*

The Bankruptcy Court ruled that "the interests of current tort creditors and the absence of viable protections for future tort claimants outside of bankruptcy ... constitute such 'unusual circumstances' as to preclude ... dismissal." App. 13 (Mot. to Dismiss Op. 13 n.8). But what is unusual instead is that a debtor comes to bankruptcy with the insurance accorded LTL. Our ground for dismissal is LTL's lack of financial distress. No "reasonable justification" validates that missing requirement in this case. And we cannot currently see how its lack of financial distress could be overcome. For these reasons, we go counter to the Bankruptcy Court's conclusion that "unusual circumstances" sanction LTL's Chapter 11 petition.

III. CONCLUSION

[44] Our decision dismisses the bankruptcy filing of a company created to file for bankruptcy. It restricts J&J's ability to move thousands of claims out of trial courts and into bankruptcy court so they may be resolved, in J&J's words, "equitably" and "efficiently." LTL Br. 8. But given Chapter 11's ability to redefine fundamental rights of third parties, only those facing financial distress can call on bankruptcy's tools to do so. Applied here, while LTL faces substantial future talc liability, its funding backstop plainly mitigates any financial distress foreseen on its petition date.

We do not duck an apparent irony: that J&J's triple A-rated payment obligation for LTL's liabilities, which it views as a ***111** generous protection it was never required to provide to claimants, weakened LTL's case to be in bankruptcy. Put another way, the bigger a backstop a parent company provides a subsidiary, the less fit that subsidiary is to file. But when the backstop provides ample financial support to a debtor who then seeks shelter in a system designed to protect those without it, we see this perceived incongruity dispelled.

That said, we mean not to discourage lawyers from being inventive and management from experimenting with novel solutions. Creative crafting in the law can at times accrue to the benefit of all, or nearly all, stakeholders. Thus we need not lay down a rule that no nontraditional debtor could ever satisfy the Code's good-faith requirement.

But here J&J's belief that this bankruptcy creates the best of all possible worlds for it and the talc claimants is not enough, no matter how sincerely held. Nor is the Bankruptcy Court's commendable effort to resolve a more-than-thorny problem. These cannot displace the rule that resort to Chapter 11 is appropriate only for entities facing financial distress. This safeguard ensures that claimants' pre-bankruptcy remedies—here, the chance to prove to a jury of their peers injuries claimed to be caused by a consumer product—are disrupted only when necessary.

Some may argue any divisional merger to excise the liability and stigma of a product gone bad contradicts the principles and purposes of the Bankruptcy Code. But even that is a call that awaits another day and another case. For here the debtor was in no financial distress when it sought Chapter 11 protection. To ignore a parent (and grandparent) safety net shielding all liability then foreseen would allow tunnel vision to create a legal blind spot. We will not do so.

Because it abused its discretion in denying the motions to dismiss, we reverse the Bankruptcy Court's order denying the motions and remand this case with the instruction to dismiss LTL's Chapter 11 petition. Dismissing its case annuls the litigation stay ordered by the Court and makes moot the need to decide that issue.

All Citations

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Footnotes

1 The talc litigation also involves claims regarding Shower to Shower, a different talc-containing product initially produced by J&J and later by Old Consumer and its predecessors. LTL maintains intercompany transactions involving J&J and Old Consumer ultimately made the latter responsible for all claims stemming from Shower to Shower. Because the talc litigation concerns mainly Johnson's Baby Powder, for convenience references herein to that name may include other talc products.

2 Adam Lisman, assistant controller for J&J, suggested in his trial testimony that it was J&J's general policy to consider the next 24 months when calculating contingent costs under GAAP.

3 A slightly abbreviated summary of the many steps is as follows. Old Consumer merged into Chenango Zero, LLC, a Texas limited liability company and indirect, wholly owned subsidiary of J&J (“Chenango Zero”), with Chenango Zero surviving the merger. Chenango Zero (formerly Old Consumer) effected a divisional merger under the Texas Business Organizations Code by which two new Texas limited liability companies were created, Chenango One LLC (“Chenango One”) and Chenango Two LLC (“Chenango Two”), and Chenango Zero ceased to exist. Chenango One then converted into a North Carolina limited liability company and changed its name to “LTL Management LLC.” Chenango Two merged into Curahee Holding Company Inc., the direct parent company of LTL (“Curahee”). Curahee survived the merger and changed its name to “Johnson & Johnson Consumer Inc.” (now New Consumer).

4 On the day of the divisional merger, the Funding Agreement was executed by Chenango Zero (formerly Old Consumer), as payee, along with J&J and Curahee, as payors. Then, per the divisional merger, LTL was allocated rights as payee under the Funding Agreement, replacing Chenango Zero. Chenango Two (which assumed Old Consumer's assets not allocated to LTL) then merged into Curahee, one of the two original payors, and became New Consumer.

5 LTL's liability was for all talc claims except those where the exclusive remedy existed under a workers' compensation statute or similar laws.

6 For LTL to require J&J and New Consumer to fund, certain customary representations and warranties made by LTL must be true, such as those addressing its good standing under state law, the due authorization of

the Funding Agreement, and the absence of any required governmental approval. And LTL must not have violated its covenants, specifically, that it will use the funds for only permitted uses and materially perform its indemnification obligations owed to New Consumer for all talc liabilities as set out in the plan of divisional merger.

7 In each calculation of New Consumer's value, its obligation under the Funding Agreement is not included.

8 In the Fourth Circuit, a court can only dismiss a bankruptcy petition for lack of good faith on a showing of the debtor's "subjective bad faith" and the "objective futility of any possible reorganization." *Carolin Corp. v. Miller*, 886 F.2d 693, 694 (4th Cir. 1989). The Bankruptcy Court in the District of New Jersey described this as a "much more stringent standard for dismissal of a case for lacking good faith" than the Third Circuit's test. App. 13 (Mot. to Dismiss Op. 13). Perhaps not by coincidence then, debtors formed by divisional mergers and bearing substantial asbestos liability seem to prefer filing in the Fourth Circuit, with four such cases being filed in the Western District of North Carolina in the years before LTL's filing. *See In re Bestwall LLC*, Case No. 17-31795 (Bankr. W.D.N.C.); *In re DBMP LLC*, Case No. 20-30080 (Bankr. W.D.N.C.); *In re Aldrich Pump LLC*, Case No. 20-30608 (Bankr. W.D.N.C.); *In re Murray Boiler LLC*, Case No. 20-30609 (Bankr. W.D.N.C.).

9 Under certain conditions, the injunction can also channel to the trust claims against third parties affiliated with the debtor. 11 U.S.C. § 524(g)(4).

10 In the separate opinion explaining its order preserving the injunction of Third-Party Claims against Protected Parties, the Court held that "unusual circumstances" warranted extension of the automatic stay to those claims under Bankruptcy Code §§ 362(a)(1) and 362(a)(3). It also held that Bankruptcy Code § 105(a) provided it independent authority to issue a preliminary injunction enjoining them. App. 140 (Third-Party Inj. Op.).

11 The parties contest whether the Bankruptcy Court had jurisdiction to issue the order enjoining the Third-Party Claims against the Protected Parties. Dismissing LTL's petition obviates the need to reach that question.

12 *See* Report of the National Bankruptcy Review Commission 343-44 (Oct. 20, 1997) (recognizing claims-estimation accuracy is an important component of the integrity of the mass tort bankruptcy process and noting underestimation of claims occurred in the Johns-Manville case, one of the earliest asbestos bankruptcy cases, while also pointing to the adequate funding of trusts in subsequent cases to show those risks are surmountable).

13 For instance, the A.H. Robins claimants' trust has been recognized as one that functioned effectively and remained solvent for years. There the Court and stakeholders had the benefit of data from 15 years of tort litigation by A.H. Robins before its filing. *See* Report of the National Bankruptcy Review Commission 328 n.813, 344-45 (Oct. 20, 1997) (citing Jack B. Weinstein, *Individual Justice in Mass Tort Litigation: The Effect of Class Actions, Consolidations, and other Multiparty Devices* 280 n.88, 326 n.149 (Northwestern Press 1995), and Ralph R. Mabey & Peter A. Zisser, *Improving Treatment of Future Claims: The Unfinished Business Left by the Manville Amendments*, 69 Am. Bankr. L.J. 487, 497 n.45 (1995)).

14 *See, e.g., Little Creek Dev. Co. v. Commonw. Mortg. Corp. (In re Little Creek Dev. Co.)*, 779 F.2d 1068, 1072 (5th Cir. 1986) ("Determining whether the debtor's filing for relief is in good faith depends largely upon the bankruptcy court's on-the-spot evaluation of the debtor's financial condition, motives, and the local financial realities."); *Cedar Shore Resort, Inc.*, 235 F.3d at 379-80 (in evaluating good faith, courts "consider the totality of the circumstances, including ... the debtor's financial condition, motives, and the local financial realities"; dismissing petition, in part, because the debtor was "not in dire financial straits"); *In re James Wilson Assocs.*, 965 F.2d 160, 170 (7th Cir. 1992) (recognizing that, while the Code permits a firm to file though it is not insolvent, such filings usually involve "impending insolvency"); *Cohoes Indus. Terminal*, 931 F.2d at 228 (in the context of whether a petition was frivolous under Bankruptcy Rule 9011, stating "[a]lthough a debtor need

not be *in extremis* in order to file[,] ... it must, at least, face such financial difficulty that, if it did not file at that time, it could anticipate the need to file in the future"); *see also, e.g., Barclays-Am./Bus. Credit, Inc. v. Radio WBHP, Inc.* (*In re Dixie Broad., Inc.*), 871 F.2d 1023, 1027-28 (11th Cir. 1989) (stating that whether a debtor is "financially distressed" is one factor evidencing bad faith and that "the Bankruptcy Code is not intended to insulate 'financially secure' [debtors]"); *Carolin Corp.*, 886 F.2d at 701 (one prong of the good-faith inquiry is meant to ensure the petition bears "some relation to the statutory objective of resuscitating a financially troubled [debtor]") (brackets in original) (citing *Connell v. Coastal Cable T.V., Inc. (In re Coastal Cable T.V., Inc.)*, 709 F.2d 762, 765 (1st Cir. 1983)).

15 While, as described above, the uses for which LTL may draw on the payment right change in bankruptcy (*i.e.*, LTL is permitted to draw on it to fund a claimant trust and satisfy administrative expenses), we focus on the rights available to it just prior to its filing for good-faith purposes.

16 Because we arrive at the same result assuming the Bankruptcy Court was correct to determine LTL was responsible to indemnify J&J for *all* talc costs it incurs, we need not opine on this conclusion. Still, we note certain pertinent factors lack full discussion in the Court's analysis of the indemnity agreement relating to Johnson's Baby Powder in the 1979 Spin Off. App. 163-69 (Third-Party Inj. Op. 24-30). For example, it is not obvious LTL must indemnify J&J for the latter's independent, post-1979 conduct that is the basis of a verdict rendered against it. *See* App. 4957 (Agreement for Transfer of Assets and Bill of Sale 5 ¶ 4) (Old Consumer's predecessor agrees to assume and indemnify J&J against "all ... liabilities and obligations of every kind and description *which are allocated on the books or records of J&J* as pertaining to the BABY Division.") (emphasis added). It is also not clear the indemnity should be read to reach punitive damage verdicts rendered against J&J for its own conduct. Additionally, the Court never discussed how it reached its conclusion that Old Consumer assumed responsibility from J&J for *all* claims relating to Shower to Shower.

17 In saying the nature of the payment right and a lack of meaningful operations show that LTL did not suffer from sufficient kinds of financial distress, we focus on the special circumstances here and do not suggest the presence of these characteristics would preclude a finding of financial distress in every case.

18 Some might read our logic to suggest LTL need only part with its funding backstop to render itself fit for a renewed filing. While this question is also premature, we note interested parties may seek to "avoid any transfer" made within two years of any bankruptcy filing by a debtor who "receive[s] less than a reasonably equivalent value in exchange for such transfer" and "became insolvent as a result of [it]." 11 U.S.C. § 548(a). So if the question becomes ripe, the next one might be: Did LTL receive reasonably equivalent value in exchange for forgoing its rights under the Funding Agreement?

19 Because we conclude LTL's petition has no valid bankruptcy purpose, we need not ask whether it was filed "merely to obtain a tactical litigation advantage." *BEPCO*, 589 F.3d at 618. Yet it is clear LTL's bankruptcy filing aimed to beat back talc litigation in trial courts. Still "[i]t is not bad faith to seek to gain an advantage from declaring bankruptcy—why else would one declare it?" *James Wilson Assoc.*, 965 F.2d at 170. While we ultimately leave the question unaddressed, a filing to change the forum of litigation where there is no financial distress raises, as it did in *SGL Carbon*, the specter of "abuse which must be guarded against to protect the integrity of the bankruptcy system." 200 F.3d at 169.

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Most Negative Treatment: Distinguished
Most Recent Distinguished: IFP Technologies (Canada) Inc v. EnCana Midstream and Marketing | 2022 ABKB 807, 2022 CarswellAlta 3553, [2023] A.W.L.D. 4083, [2023] A.W.L.D. 4084, [2023] A.W.L.D. 4085 | (Alta. K.B., Dec 2, 2022)

2022 ABCA 111
Alberta Court of Appeal

PricewaterhouseCoopers Inc v. Perpetual Energy Inc

2022 CarswellAlta 805, 2022 ABCA 111, [2022] A.W.L.D. 1729, 2022 A.C.W.S. 671, 98 C.B.R. (6th) 161

PricewaterhouseCoopers Inc., LIT, in its capacity as the Trustee in Bankruptcy of Sequoia Resources Corp. and not in its personal capacity (Appellant / Respondent) and Perpetual Energy Inc., Perpetual Operating Trust, Perpetual Operating Corp., and Susan Riddell Rose (Respondents / Applicants) and Orphan Well Association, Canadian Natural Resources Limited, Cenovus Energy Inc. and Torxen Energy Ltd. (Intervenors)

Patricia Rowbotham, Ritu Khullar, Jolaine Antonio JJ.A.

Heard: February 10, 2022
Judgment: March 25, 2022
Docket: Calgary Appeal 2101-0021AC

Proceedings: reversing *PricewaterhouseCoopers Inc v. Perpetual Energy Inc* (2021), 2021 ABQB 2, 2021 CarswellAlta 88, D.B. Nixon J. (Alta. Q.B.)

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Subject: Civil Practice and Procedure; Insolvency; Public

Related Abridgment Classifications

Bankruptcy and insolvency
XI Avoidance of transactions prior to bankruptcy
  XI.1 Fraudulent preferences
    XI.1.b Insolvency of debtor at time of transaction

Headnote

Bankruptcy and insolvency --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — Insolvency of debtor at time of transaction
Appellant was trustee, who brought action against respondent company and its principal — Trustee alleged that company was insolvent when asset transfer took place — Respondents applied to chambers judge to have action dismissed — Application

was successful — Trustee appealed from this judgment — Appeal allowed — Chambers judge erred on issue of end-of-life obligations as to value of subject assets — Chambers judge did not consider whether these obligations should have been accounted for in another way — When obligations were properly valued, insolvency of company was likely if not proven — Legal error was basis for allowing appeal — Remaining grounds of appeal did not have to be considered.

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Finance LLC v. United Steelworkers) [2013] 1 S.C.R. 271, 2 C.C.P.B. (2nd) 1 (S.C.C.) — referred to

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Weir-Jones Technical Services Incorporated v. Purolator Courier Ltd. (2019), 2019 ABCA 49, 2019 CarswellAlta 204, 32 C.P.C. (8th) 247, [2019] 6 W.W.R. 567, 86 Alta. L.R. (6th) 240, 442 D.L.R. (4th) 9 (Alta. C.A.) — referred to

Wolverton Securities Ltd. v. Schemel (2009), 2009 BCSC 1048, 2009 CarswellBC 2101, 56 C.B.R. (5th) 47 (B.C. S.C.) — referred to

385268 B.C. Ltd. v. Alberta Treasury Branches (2000), 2000 CarswellAlta 650, 20 C.B.R. (4th) 310, 267 A.R. 384 (Alta. Q.B.) — referred to

385268 B.C. Ltd. v. Alberta Treasury Branches (2001), 2001 ABCA 289, 2001 CarswellAlta 1572, 29 C.B.R. (4th) 315, (sub nom. *385268 B.C. Ltd. v. Alberta (Treasury Branches))* 299 A.R. 194, (sub nom. *385268 B.C. Ltd. v. Alberta (Treasury Branches))* 266 W.A.C. 194 (Alta. C.A.) — referred to

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

s. 2 “insolvent person” — referred to

s. 2 “insolvent person” (c) — referred to

s. 2 “transfer at undervalue” — referred to

s. 96 — referred to

s. 96(1) — referred to

Interpretation Act, R.S.C. 1985, c. I-21
s. 12 — referred to

Rules considered:

Alberta Rules of Court, Alta. Reg. 124/2010
R. 7.1 — referred to

R. 7.3 — referred to

R. 7.3(1)(b) — referred to

R. 7.3(3)(a) — referred to

R. 7.3(3)(c) — referred to

APPEAL by trustee, from judgment reported at *PricewaterhouseCoopers Inc v. Perpetual Energy Inc* (2021), 2021 ABQB 2, 2021 CarswellAlta 88 (Alta. Q.B.), granting judgment to respondent companies in bankruptcy proceedings.

***Per curiam*:**

1 The appellant Trustee in bankruptcy filed a statement of claim against the respondents, alleging among other things that an asset transaction was void under s 96 of the Bankruptcy and Insolvency Act, RSC 1985, c B–3 [BIA]. That is, the Trustee alleged the recipient company was insolvent when the assets were transferred at undervalue, or the recipient company was rendered insolvent by the transfer at undervalue. The transferred assets were licenced petroleum assets, mainly shallow gas wells. Almost two thirds of them were shut-in or abandoned, such that the associated end-of-life obligations were significant.

2 Perpetual Energy Inc. (Perpetual Energy Parent), Perpetual Operating Trust (POT) and Perpetual Operating Corp. (collectively, the Perpetual Defendants) twice applied to the same chambers justice to have the s 96 claim dismissed. This appeal arises from the second summary dismissal application, at which the Perpetual Defendants were successful.

3 We have concluded that the chambers judge committed three errors. First, in assessing the effect of end-of-life obligations on insolvency, he focused his analysis on whether end-of-life obligations could be defined as an "obligation due or accruing due", but failed to analyse whether they could have an effect on the value of assets [see paragraphs 30 to 57]. Second, although some of the end-of-life obligations were accounted for in the valuation of the assets, this included only 26% of the abandoned wells and therefore did not adequately represent the depressed value of the assets [see paragraphs 58 to 70] Finally, the second application for the same relief was an abuse of the court's process and should never have been heard [see paragraphs 75 to 103]. The appeal is allowed and the matter is directed to trial.

Background

4 The appellant, PricewaterhouseCoopers Inc., LIT, in its capacity as Trustee in Bankruptcy of Sequoia Resources Corp. (Trustee) sued the Perpetual Defendants and Ms Susan Riddell Rose for their involvement in the October 2016 corporate reorganization and sale of Perpetual Energy Operating Corp. (PEOC) to a third party. The corporate reorganization was effected in October 2016 through a multi-part transaction and sale (Aggregate Transaction). Ms Rose was the sole director of PEOC until the closing of the Aggregate Transaction. After the Aggregate Transaction, PEOC changed its name to Sequoia Resources Corp. (Perpetual/Sequoia) and carried on business for approximately 17 months. It assigned itself into bankruptcy in March 2018.

5 Before the Aggregate Transaction, POT held the beneficial interest in several oil and gas assets. The sole beneficiary of the trust was Perpetual Energy Parent. The legal title to the assets, and the regulatory licences to them, were held by PEOC. PEOC had no other business interests; it only existed to be the Trustee of the assets. At issue in this appeal is the group of mature legacy assets, including several shallow gas wells and related assets, known as the Goodyear Assets.

6 One step in the Aggregate Transaction was the transfer of the beneficial interest in the Goodyear Assets from POT to PEOC (Asset Transaction). The Trustee challenges the Asset Transaction, asserting it was at an undervalue by more than $217 million. It filed a Statement of Claim in August 2018 seeking remedies against the Perpetual Defendants and Ms Rose on the basis of four claims, of which only one is relevant to this appeal: the Asset Transaction was void under s 96 of the BIA since it was not at arm's-length, it was within five years preceding the bankruptcy, and it was a transfer at undervalue.

7 The history of this matter is complicated and involves an earlier appeal to this Court. A detailed chronology is contained in the Appendix at the end of this judgement.

8 In 2018, at the same time it filed its statement of claim, the Trustee applied for summary judgment of all claims. The Perpetual Defendants and Ms Rose responded with applications to summarily dismiss or strike the claims. It was determined that the respondents' applications to summarily dismiss and to strike the Trustee's claims would be addressed first and the Trustee's application was stayed. At first instance, the respondents' applications were largely successful with numerous claims either dismissed or struck (2020 ABQB 6 (Alta. Q.B.) [*First Chambers Decision*,]), but these results were overturned by this Court on appeal (2021 ABCA 16 (Alta. C.A.) [*First Appellate Decision*,]) respectively.

9 In addition to addressing the numerous claims and test for summary judgment, the *First Appellate Decision* provided guidance on the interpretation of Orphan Well Association v Grant Thornton Ltd 2019 SCC 5 [Redwater] and the legal nature of end-of-life obligations.

10 A claim under s 96 of the BIA contains numerous elements, all of which must be satisfied for the Trustee to be successful. In the first chambers application, the Perpetual Defendants challenged the s 96 claim on only one element, namely, that at the Aggregate Transaction level, the parties were at arms-length. If the parties were acting at arms-length, then the one year look- back period applied, and the Trustee was out of time to commence the s 96 claim (the First Chambers Application). In the *First Chambers Decision* , the chambers judge ruled the arms-length issue could not be determined on a summary basis. That result was upheld in the *First Appellate Decision* .

11 After the *First Chambers Decision* was released, but before the first appeal was heard, the Perpetual Defendants filed the second chambers application before the same chambers judge. They sought summary dismissal or striking of the s 96 claim for the second time. This time, however, they argued (i) PEOC was not insolvent at the time of the Asset Transaction or rendered insolvent by it within the meaning of the *BIA* (the insolvency element); and (ii) there was no transfer at undervalue within the meaning of the *BIA* (the transfer at undervalue element) (the Second Chambers Application).

12 In addition to opposing the Perpetual Defendants' submissions on the insolvency and transfer at undervalue elements, the Trustee argued the Second Chambers Application was an abuse of process because: (i) Perpetual Energy Parent's Vice-President, Finance, and Chief Financial Officer, W. Mark Schweitzer, swore two affidavits on May 5, 2020 that took different positions; (ii) the s 96 *BIA* claim had already been argued and decided at the First Chambers Application; and (iii) Perpetual Defendants' argument at the Second Chambers Application was inconsistent with its pleadings.

Second Chambers Decision: 2021 ABQB 2

13 The chambers judge's discussion of abuse of process was brief. He found that Mr Schweitzer's affidavits addressed different scenarios and focused on two different timeframes. Thus they did not amount to an abuse of process: 2021 ABQB 2 (Alta. Q.B.) at para 47 [*Second Chambers Decision*,].

14 At paragraphs 43-46 and 48 of the *Second Chambers Decision*, the chambers judge relied on the foundational rules and the fact that the different elements of s 96 of the BIA were in issue in each of the two chambers applications. He concluded there was no abuse of process, provided the Second Chambers Application addressed only matters not previously decided.

15 Regarding the merits of the Second Chambers Application, the chambers judge expressly declined to consider the arguments on transfer at undervalue, finding several related issues were not suitable to summary disposition but should instead be explored in the trial proper: *Second Chambers Decision* at para 64. In the result, the chambers judge concluded it was only necessary to consider the insolvency element.

16 The insolvency element of s 96 finds its roots in the definition of "insolvent person" in s 2 of the BIA, which contains three insolvency tests in addition to some criteria that are not in issue here. The third test, known as the Balance Sheet Solvency Test, provides that a person is insolvent if the aggregate of their property "is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due."

17 In its statement of claim, the Trustee pled that Perpetual/Sequoia was either insolvent at the time of the Asset Transaction or rendered insolvent by it. The Trustee primarily defended the Second Chambers Application on the basis that the Balance Sheet Solvency Test was not met.

18 In keeping with the parties' submissions, the chambers judge framed the issue under the Balance Sheet Solvency Test as whether the end-of-life obligations, which he called asset retirement obligations or ARO, associated with the Goodyear Assets were "obligations, due or accruing due": *Second Chambers Decision* at paras 20, 79-83, 126-128, 160; 171, 187, 194, 204, 247, 261, 269.

19 In setting out the framework for his analysis of "obligations, due and accruing due", the chambers judge adopted three financial variables from the Trustee's submissions: (i) the value of the consideration received by Sequoia/Perpetual (Value Variable); (ii) the asset retirement obligations (ARO Variable); and (iii) property taxes (Property Tax Variable) (collectively, the Financial Variables): *Second Chambers Decision* at para 80. For the Value Variable, the chambers judge accepted a value of $5,670,200: *Second Chambers Decision* at paras 189-192, 203. For the Property Tax Variable, he accepted the amount of $1,560,890 as found in his *First Chambers Decision* : *Second Chambers Decision* at paras 202, 257-258. Adopting the chambers judge's findings in the *First Chambers Decision* , the Perpetual Defendants submitted end-of-life obligations were not an obligation due or accruing due and therefore their value for the Balance Sheet Solvency Test was nil.

20 The phrase "obligations, due and accruing due" is not defined in the *BIA*. The chambers judge undertook a statutory interpretation analysis having regard to jurisprudence, established business and accounting principles, organizations such as

the Uniform Law Conference of Canada and Alberta Law Reform Institute, and academia. He concluded that to constitute "obligations, due and accruing due" a liability must be completely constituted and presently exigible. He found ARO do not meet this test and therefore have nil value for purposes of the Balance Sheet Solvency Test: *Second Chambers Decision* at paras 194, 204. The chambers judge was of the view that ARO, at best, were a mere estimate of obligations that would be impacted by unknown legislative changes over the decades to come: *Second Chambers Decision* at paras 113, 204.

21 Since the ARO liability was valued at nil, and the value of the assets exceeded the value of the other liabilities, the chambers judge was satisfied that Perpetual/Sequoia was not insolvent or rendered insolvent by the Asset Transaction.

22 The chambers judge declined to strike the Trustee's claim but found summary dismissal was an appropriate remedy given the state of the evidence, his interpretation of the law, and his conclusions on the Financial Variables. He dismissed the s 96 claim.

23 The *Second Chambers Decision* was released several days before the *First Appellate Decision* . As a result, the chambers judge did not have the benefit of this Court's guidance on the legal nature of end-of-life obligations.

Grounds of appeal

24 The Trustee appeals, alleging the chambers judge erred in:

a) failing to consider that end-of-life obligations affected the value of Perpetual/Sequoia's assets;

b) finding that end-of-life obligations are a "mere accounting estimate";

c) his analysis of s 96 of the BIA;

d) excluding end-of-life obligations from the insolvency analysis under s 96 on the basis that it was not "completely constituted and presently exigible";

e) finding that the Second Chambers Application was not an abuse of process.

25 The Orphan Well Association and three oil and gas industry players, Canadian Natural Resources Limited, Cenovus Energy Inc., and Torxen Energy Inc. were granted intervenor status on the application and this appeal. They also assert the chambers judge erred in finding that end-of-life obligations are not considered in applying the test for insolvency.

26 The Perpetual Defendants and Ms Rose agree that end-of-life obligations are real obligations that depress asset value. They submit the chambers judge correctly concluded end-of-life obligations are not "obligations due and accruing due", and therefore are valued at nil on the liability side of the Balance Sheet Solvency Test. His decision should be upheld because the figure he adopted for the Value Variable incorporated end-of-life obligations as depressing the value of the represented assets. Therefore he did not err in dismissing the s 96 claim on the basis of the insolvency element.

27 In the alternative, the Perpetual Defendants assert the decision can be upheld on the basis that there was no transfer, and therefore no transfer at undervalue. In light of our other findings, it is not necessary to address this alternative argument, except to note that on the record available to us, it is not persuasive.

Standard of review

28 The legal status of end-of-life obligations and their proper characterization under the *BIA* is a question of law for which the standard of review is correctness.

29 A court's determination of whether abuse of process is established is a discretionary finding. It is reversible where the court of first instance misdirected itself, gave no or insufficient weight to relevant considerations, or came to a decision so clearly wrong it amounts to an injustice: Penner v Niagara (Regional Police Services Board), 2013 SCC 19 at para 27.

Analysis

A. Section 96 of the BIA and the Balance Sheet Solvency Test

30 The Trustee submits the chambers judge erred in failing to fully consider the impact of end-of-life obligations on the value of the Goodyear Assets. The respondents counter that his legal treatment of the end-of-life obligations was correct, and in any event he did incorporate them into his valuation of the assets, such that the error did not effect the outcome.

31 We find the chambers judge erred in law by framing too narrow a question: whether end-of-life assets could be considered "obligations, due or accruing due". Contrary to *Redwater* and the *First Appellate Decision* , he did not consider whether the entirety of the end-of-life obligations could or should be incorporated elsewhere in the Balance Sheet Solvency Test. This omission tainted the entire insolvency analysis. On the record before us, we cannot conclude the error was without consequence. The appeal is allowed on this ground.

i. Section 96 of the BIA

32 Section 96 of the BIA allows a trustee in bankruptcy to challenge a debtor's pre-bankruptcy transfers at undervalue. It provides:

> 96 (1) On application by the trustee, a court may declare that a transfer at undervalue is void as against, or, in Quebec, may not be set up against, the trustee — or order that a party to the transfer or any other person who is privy to the transfer, or all of those persons, pay to the estate the difference between the value of the consideration received by the debtor and the value of the consideration given by the debtor — if
>
> (a) the party was dealing at arm's length with the debtor and
>
> (i) the transfer occurred during the period that begins on the day that is one year before the date of the initial bankruptcy event and that ends on the date of the bankruptcy,
>
> (ii) the debtor was insolvent at the time of the transfer or was rendered insolvent by it, and
>
> (iii) the debtor intended to defraud, defeat or delay a creditor; or
>
> (b) the party was not dealing at arm's length with the debtor and
>
> (i) the transfer occurred during the period that begins on the day that is one year before the date of the initial bankruptcy event and ends on the date of the bankruptcy, or
>
> (ii) the transfer occurred during the period that begins on the day that is five years before the date of the initial bankruptcy event and ends on the day before the day on which the period referred to in subparagraph (i) begins and
>
> (A) the debtor was insolvent at the time of the transfer or was rendered insolvent by it, or
>
> (B) the debtor intended to defraud, defeat or delay a creditor.

33 A "transfer at undervalue" is defined as a "disposition of property or provision of services for which no consideration is received by the debtor or for which the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor": BIA, s 2.

34 As noted by the chambers judge at paragraphs 52-56 of the *Second Chambers Decision*, there are five distinct elements embedded in the framework of s 96 of the BIA. The focus of the *Second Chambers Decision* was the insolvency element: whether “the debtor was insolvent at the time of the transfer or was rendered insolvent by it.” The chambers judge correctly concluded the insolvency element engaged the definition of insolvent person in s 2 of the BIA:

> **insolvent person** means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and
>
> (a) who is for any reason unable to meet his obligations as they generally become due,
>
> (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or
>
> (c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due;

The only contentious element of the insolvent person test was subparagraph (c), the Balance Sheet Solvency Test.

ii. The Balance Sheet Solvency Test

35 Applying the Balance Sheet Solvency Test post-*Redwater* to pre-*Redwater* affidavits, proved to be something of a linguistic and legal minefield. Even in 2020, when the Second Chambers Application was argued, the parties demonstrated uncertainty as to how *Redwater* influenced the interpretation of pre-existing accounting records and opinions.

36 In their submissions on the Balance Sheet Solvency Test, the parties used accounting terms such as “liabilities” and “obligations”. For example, the Trustee argued that all line items listed in the “liabilities” section of the balance sheet are to be included in assessing the insolvency element and that every “obligation” is to be included when applying the Balance Sheet Insolvency Test: *Second Chambers Decision* at para 93. The Trustee’s estimated valuation of the PEOC transaction recorded a positive value for some of the Goodyear Assets, net of end-of-life obligations, while recording a separate negative value for “working interest ARO liability for PEOC wells”. An affidavit filed on behalf of the intervener CNRL described different purpose-dependent treatments of end-of-life obligations. For instance, they are incorporated into the market value of an asset for purposes of evaluating and negotiating an asset transaction but they are included in a licencee’s financial documents, including balance sheets, as a liability.

37 On both sides, the parties characterized the issue as whether end-of-life obligations were liabilities. To sidestep the linguistic traps and to avoid any assumption that a line item within the liabilities section of a party’s balance sheet was automatically a “genuine liability” as a matter of law, the chambers judge used the term “the right-hand side of the balance sheet” instead of “the liability side”: see discussion at footnote 4 of the *Second Chambers Decision*.

38 Nonetheless, the chambers judge followed the parties’ framing of the argument and “view[ed] the characterization of the ARO as being the sole legal issue”: *Second Chambers Decision* at para 245. At paragraph 127 he narrowed “the underlying question” to “the scope of the phrase ‘obligations, due and accruing due’ within clause (c)” of the insolvency test. At paragraph 261 he reiterated, “The issue pivots on whether an accounting estimate concerning a future cash outflow falls within the ambit of ‘obligations, due and accruing due’”. If it were “properly characterized as falling within the scope of ‘obligations, due and accruing due’ for purposes of the Insolvency Element”, the matter would go to trial. If not, “then the Section 96 *BIA* Claim fails because the Insolvency Element would not be satisfied”: *Second Chambers Decision* at para 247. Put still more starkly at para 269, “the substantive issue concerns the characterization of the ARO. If the ARO is not captured by the phrase ‘obligations, due and accruing due’, then the foundation for the Section 96 *BIA* Claim crumbles.” The chambers judge concluded that end-of-life obligations were not “obligations, due and accruing due” and therefore their value was “Nil for purposes of clause (c) of the Insolvent Person Definition”: *Second Chambers Decision* at para 204.

39 This narrow framing of the legal issue led to error, since the chambers judge did not consider whether the end-of-life

obligations should have been accounted for in another way. As *Redwater* and the *First Appellate Decision* have made clear, end-of-life obligations are an inherent part of asset value. When they do not constitute a conventional debt payable to an identifiable creditor, it will be appropriate to account for them as depressing values on the left-hand side of the balance sheet. The *BIA* claim would not necessarily crumble because the obligations did not amount to "obligations, due and accruing due" on the right-hand side.

40 It is easy to see how the chambers judge was led into error given the parties' submissions. Regardless, he was obliged to evaluate the arguments and evidence in light of the relevant law. The correct legal approach is not defined by the industry's accounting practices or the accounting evidence: *Second Chambers Decision* at para 23 and sources cited therein. As noted by the chambers judge, "the issue of how the ARO is dealt with is a question of law": *Second Chambers Decision* at para 260.

iii. Error in the legal characterization of end-of-life obligations

41 Stripped of jargon, the point of the Balance Sheet Solvency Test was to determine whether, after the Asset Transaction, Perpetual/Sequoia's assets exceeded its liabilities.

42 *Redwater* and the *First Appellate Decision* did not specifically address the insolvency issue. However, both decisions provided guidance about the nature of licenced oil and gas operations and the legal character of end-of-life obligations.

43 *Redwater* confirmed that the Alberta Energy Regulator is not a "creditor" with respect to end-of-life obligations and that end-of-life obligations cannot be a "claim provable in bankruptcy". These conclusions do not mean that end-of-life obligations are nonexistent, mere assumptions or speculations, or of nil value. Rather, end-of-life obligations are real and omnipresent, forming "a fundamental part of the value of the licensed assets": *Redwater* at para 157. They serve "to depress the tenure's value at the time of sale": *First Appellate Decision* at paras 95-96.

44 The Perpetual Defendants argued this case is not about regulating energy policy, and we agree. But the fact is that no well produces forever, so end-of-life obligations are as inevitable as death and taxes. As stated by this Court in the *First Appellate Decision* at paras 86-87:

> Abandonment and Reclamation Obligations (or "end-of-life", or "asset retirement" obligations) are inherent in any oil well, from the moment it is drilled and comes into production. At that point in time the Abandonment and Reclamation Obligations can be said to be "contingent", but only in the sense that the moment when the well will cease production is unknown. However, they are not "contingent" in the sense that they will only come into existence if, and only if, a condition precedent comes to pass: ***Redwater*** at para. 36; ***Canada v McLarty***, 2008 SCC 26 at paras. 14-18, [2008] 2 SCR 79. The only issue is <u>when</u> they will come into existence. A well may produce for decades. However, while the Abandonment and Reclamation Obligations may not crystallize for some time, they are inevitable; no well produces forever.
>
> The time at which the Abandonment and Reclamation Obligations with respect to any particular well must be performed is variable:
>
> > (a) With respect to a newly drilled well the Abandonment and Reclamation Obligations may only manifest themselves decades in the future.
> >
> > (b) Once the production of a well has peaked, and its most productive years are behind it, it may be possible to predict with some degree of certainty when the Abandonment and Reclamation Obligations will have to be performed. The closer one gets to the end of production, the more precise the date of reclamation will become.
> >
> > (c) But once a well has been exhausted, production has stopped, and the well has been shut-in, the Abandonment and Reclamation Obligations have crystallized. The Abandonment and Reclamation Obligations may be unperformed, but they are no longer "contingent" in either sense. The owner of the well is under a public duty to shut in the well and reclaim the surface.

> The further reclamation is in the future, the more difficult it will be to quantify the Abandonment and Reclamation Obligations. Even if Abandonment and Reclamation Obligations can be said to be "contingent" liabilities, that is sufficient in law for some purposes: ***Tannis Trading Inc v Coldmatic Refrigeration of Canada Ltd***, 2010 ONSC 5747 at paras. 24-25, 85 BLR (4th) 77; ***Manufacturers Life Insurance Co v AFG Industries Ltd***, 2008 CanLII 873 at para. 30, 44 BLR (4th) 277 (ONSC). Further, the present value of the Abandonment and Reclamation Obligations will directly depend on how far into the future they will arise. Abandonment and Reclamation Obligations are unliquidated, some of them may be more immediate than others, and their quantum is uncertain, but they are still inevitable. They exist whether or not abandonment notices have been issued by the Alberta Energy Regulator. Abandonment and Reclamation Obligations may not be entirely a current liability or obligation, but they are a real liability or obligation. They are routinely reported on the balance sheets of oil and gas companies, including those of Perpetual Energy Parent. [Emphasis in the original]

45 This analysis governs the application of the Balance Sheet Insolvency Test. During the producing life of an asset, end-of-life obligations will likely not be represented by fixed amounts currently owing to identified creditors. Accordingly, they will not be best characterized as conventional debts, claims provable in bankruptcy, or obligations currently due. It is more likely they will "operate by depressing the value of the assets": *First Appellate Decision* at para 97. At later stages, when reclamation work is underway, end-of-life obligations may take the form, in whole or in part, of obligations owed to identifiable creditors. In other words, time and context may determine whether it is appropriate to account for end-of-life obligations under the heading of assets or liabilities or both. As submitted by counsel for the Orphan Well Association, however, before end-of-life obligations are fully performed the only thing they cannot be is nil.

46 Lacking the benefit of the *First Appellate Decision* , the chambers judge erred in law by narrowing his legal focus to the right-hand side of the balance sheet, thereby omitting to expressly consider whether end-of-life obligations could depress the value of some or all of the assets on the left-hand side of the balance sheet.

47 Among his reasons for valuing the end-of-life obligations at nil, the chambers judge characterized them as mere estimates of uncertain future obligations: *Second Chambers Decision* at paras 104, 113, 155-156, 204. Further, the chambers judge felt there was "too much uncertainty concerning a probable obligation that is potentially payable 25 or 60 years in the future, especially when there is a very high likelihood that there will be technical and legislative changes which will impact on the 'probable obligation'": *Second Chambers Decision* at para 255.

48 Ms Rose submits the chambers judge's comments on the difficulty of quantifying end-of-life obligations were directed at the calibre of evidence, not the legal characterization of end-of-life obligations. At its highest, Ms Rose's submission may explain why the chambers judge found the end-of-life obligations did not amount to "obligations due or accruing due". It does not explain why the majority of them were valued at nil for all purposes. In any event, if the record was insufficient to establish the value of the assets and inherently associated obligations, then the Perpetual Defendants did not meet their burden on summary judgment and the matter ought to have proceeded to trial.

49 We acknowledge that valuing the end-of-life obligations, and the assets of which they are an inherent component, is unlikely to be a straightforward task. Valuation may depend on various contingencies and assumptions, as complex accounting often does. But the difficulty of assigning value to end-of-life obligations does not justify assigning them nil value. Non-zero end-of-life obligations are routinely recorded on balance sheets in the industry, and Perpetual Energy itself has done so: see, for example, the affidavits of the industry intervenors about their corporate procedures and calculations for end-of-life obligations (the Affidavit of Ron Laing, sworn August 12, 2020 at paras 10-20, the Affidavit of Antonio Jackson, sworn August 17, 2020 at paras 3-6, and the Affidavit of J.K. Brannan, sworn August 12, 2020 at paras 3-7); the Affidavit of Paul Darby, sworn September 22, 2020 at paras 10-15 and Exhibit "1" , being Perpetual Energy's 2016 Consolidated Financial Statements for the year ending December 31, 2016; and the *First Appellate Decision* at para 87.

50 The chambers judge's reference to "a very high likelihood that there will be technical and legislative changes which will impact on the 'probable obligation'" suggests a subtle but problematic misunderstanding of *Redwater*: *Second Chambers Decision* at para 255; see also para 113. This comment could be interpreted as implying that end-of-life obligations are creatures of regulation, arising when the regulator forces a licensee to undertake abandonment and reclamation work. To the contrary, the *First Appellate Decision* made clear that end-of-life obligations are an intrinsic part of a license, existing "whether or not abandonment notices have been issued by the Alberta Energy Regulator": *First Appellate Decision* at para

87; see also *Redwater* at para 29 and PanAmericana de Bienes y Servicios v Northern Badger Oil & Gas Ltd,1991 ABCA 181 at paras 32–33. It seems the term "ARO" may have traditionally had a connotative association with regulatory enforcement. In these reasons we have instead used the term "end-of-life obligations" to underscore that the obligations are inevitable and inherent to licenced assets regardless of regulatory involvement after the moment of licensing. To the extent the chambers judge understood end-of-life obligations to arise from regulatory enforcement, he was incorrect.

51 Finally, at paragraph 124 of the *Second Chambers Decision*, the chambers judge expressed concern that including end-of-life obligations in the Balance Sheet Solvency Test would immediately render many of the oil and gas entities insolvent:

> I also note with particular interest that in ***Industries Cover***, Pinsonnault, JCS cites Justice Fournier in ***Bonneau (Faillite de)***, 1997 CanLII 8560 (QC CS) at paras 36 to 29 that it would be non-sensical to adopt an expansive interpretation of "obligations, accruing due" for the purposes of determining insolvency because including all future payments as due on the spot in the balance sheet test would result in a good part of the population being insolvent: ***Industries Cover*** at para 425; see also ***Villeneuve c Villeneuve***, 2007 QCCS 4468 at paras 31 and 32. Given the economic climate in Canada that is currently impacting the oil and gas industry, I infer that the same concern exists for the participants in that economic sector. That is, applying the Trustee's interpretation would likely render many of the oil and gas entities operating in Canada insolvent as at the date of this decision.

The authorities cited in the above paragraph hold that if everyone obligated to make monthly payments toward a large debt were to adopt the fiction that the entire debt was "accruing due" at a given moment, a significant portion of the population could or should declare bankruptcy. That would be nonsensical; therefore the *BIA* should not be so interpreted. Instead, the nature and timelines of all obligations "accruing due" should be considered when interpreting the Balance Sheet Insolvency Test.

52 The chambers judge's reference to these authorities was inapt. Refusing to collapse all future debt payments to the present moment will be a sound analysis of obligations "accruing due" in certain contexts, such as individual homeowners with mortgages. But it is not a useful approach to end-of-life obligations, which generally exert a depressing effect on value but are not conventional debts and are not subject to structured payments. They cannot be analogized to mortgages.

53 In *Daishowa-Marubeni International Ltd v Canada*, 2013 SCC 29, the Supreme Court considered the tax treatment of forest tenures subject to reforestation obligations. At paragraphs 28-29, it rejected the mortgage analogy, finding that a more apt comparison would be to a property in need of repair:

> DMI, supported by the industry interveners, submits that the analogy to a mortgage is misplaced. In their view, a forest tenure with reforestation obligations that have arisen from past harvesting is better analogized to property that is in need of repair. The need for repairs has the effect of depressing the property's value. If property in need of repair is sold, the purchaser's assumption of the cost of repairs does not form an additional part of the sale price of the property. And, as the Minister acknowledged at the oral hearing, the vendor would not be required to include in its proceeds of disposition an amount to reflect the estimated repair costs assumed by the purchaser. This would be true even if the parties attributed a value to the cost of those repairs in their contract and even if the repairs were required by law; see M. Colborne and S. Suarez, "Timber! Consequences of Assuming Reforestation Obligations" (2012), 60 *Can. Tax J.* 137, at p. 142.
>
> I agree with Mainville J.A., DMI and the industry interveners that the assumed reforestation obligations are not appropriately characterized as the assumption of an existing debt of the vendor that forms part of the sale price of the property. <u>The obligations — much like needed repairs to property — are a future cost embedded in the forest tenure that serves to depress the tenure's value at the time of sale. This is different from a mortgage, which . . . does not affect the value of the property it encumbers.</u> [Emphasis added]

In *Redwater* at paragraph 157, the Supreme Court noted its conclusion that end-of-life obligations form a fundamental part of licenced petroleum assets, potentially depressing their value, was consistent with *Daishowa.*

54 Building on the repair analogy, end-of-life obligations could be loosely thought of as asbestos in the walls of a house. It will need to be rectified sooner or later, and someone will have to pay for it. If work is underway or complete, any

outstanding payment for the work may be an obligation due or accruing due. Until then, however, the house is worth less than a similar asbestos-free house. The asbestos depresses the value of the house.

55 Finally, applying the mortgage analogy, the chambers judge inferred that an expansive interpretation of "obligations due or accruing due" would likely render many industry players insolvent immediately. There was little evidence to support this inference. To the contrary, the record suggests industry actors routinely account for end-of-life obligations on their own balance sheets in some fashion but are not routinely rendered insolvent by that accounting. After a well has finished producing, it is likely to be a net liability, but that is a fact of life, not an error in accounting or law.

56 At paragraphs 185 and 187 of the *Second Chambers Decision* the chambers judge acknowledged the industry intervenors' arguments that the end-of-life obligations impacted the determination of the fair market value of the Goodyear Assets. However, he concluded this point went to the issue of whether there was a transfer at undervalue and transfer under undervalue should not be decided by way of summary dismissal:

> . . . In its written submissions, the Industry Intervenors argued that the relevant consideration of ARO in the Balance Sheet Solvency Test was not focused on the whether it was an obligation or a debt. Rather, the Industry Intervenors argued that the ARO was a critical and fundamental component of the determination of the fair market value of the person's aggregate property.
>
> . . .
>
> Concerning the arguments provided by the Industry Intervenors, its substantive focus was on the impact that ARO has on the determination of the fair market value of the person's property. That point goes to the issue of whether there was a transfer at undervalue, as opposed to whether the ARO falls within the ambit of the phrase "obligations, due and accruing due". That raises a number of issues, which is why I stated above that if it was the Transfer at Undervalue Element that was in issue, it should not be decided by way of summary judgment under Rule 7.3.

57 Though not perfectly clear, it appears the chambers judge felt that while "obligations, due and accruing due" could be determined summarily, valuation of the assets and consideration could not. Of course, the determination of asset value is also a component of the Balance Sheet Solvency Test. If valuation could not be summarily determined for purposes of the transfer at undervalue analysis, it follows it could not be summarily determined for purposes of the insolvency analysis.

iv. The legal error affected the result

58 The respondents acknowledge that, following *Redwater*, end-of-life obligations must be accounted for when valuing licenced assets, likely by depressing the values on the left-hand side of the balance sheet. They submit the chambers judge adopted asset values that incorporated end-of-life obligations; therefore even if his analytical focus on the right-hand side was legally incorrect, it did not impact the result. To the contrary, they say, he would have erred if he had acceded to the Trustee's request to include end-of-life obligations on the right-hand side as well, resulting in wrongful double-counting.

59 After a careful review of the record, we have concluded the chambers judge did not fully account for the end-of-life obligations.

60 The chambers judge adopted $5,670,200 as the value of the Goodyear Assets, drawn from the Affidavit of Paul Darby filed in support of the Trustee's 2018 summary judgment application. The source of the figure was one of four reserve reports prepared by the Perpetual Defendants in advance of the Aggregate Transaction. The full reserve report was not included in the evidence and its methodology was not explained.

61 At the time of the Second Chambers Application, the Perpetual Defendants were amenable to using $5,670,200 as the value of the Goodyear Assets: see the Affidavit of W. Mark Schweitzer May 5, 2020 at para 11. By contrast, in the First Chambers Application, the Perpetual Defendants objected to using the reserve reports for valuation. Mr Schweitzer deposed to various reasons reserve reports are not sufficient to establish the fair value of assets (Affidavit of October 3, 2018 at para 12): reserve reports are based on numerous assumptions regarding, for instance, available financing, timing of planned

expenditures, capital and operating costs and forecasted prices; reserve report information is effective at a fixed point in time; reserve reports do not include the value of other assets, such as pipelines, other surface facilities, prospect drilling inventory and undeveloped acreage; they do not account for a buyer's view of its ability to increase the value of the reserves and other assets under its own business plan; they do not consider price risk management positions or cost structure reductions that a buyer and seller may negotiate in determining fair market value; and they do not consider the cost of financing, timing of planned expenditures, changes in development and operating strategies and costs that a buyer may bring to the assets.

62 Mr Darby's Affidavit included excerpts from the Perpetual Defendants' reserve reports, some assumptions about the reports, and an explanation of how the Trustee concluded the Asset Transfer was made at undervalue. The $5,670,200 value for the Goodyear Assets came from a 2016 reserve report and was said to be net of associated end-of-life obligations. Importantly, Mr Darby noted the value only included 652 of the 2,502 wells comprising the Goodyear Assets. In other words, the value included about 26% of the wells but excluded about 74%.

63 The existence of a reserve report for the 652 wells suggests those assets were still producing to some degree. In the *First Appellate Decision* at paragraph 88, this Court noted the Goodyear Assets included 910 shut-in wells and 727 abandoned wells, for a total of 1,637 non-producing wells. End-of-life obligations weigh more heavily in the valuation of non-producing wells.

64 Mr Darby provided details on how the Trustee approached end-of-life obligations in assessing whether the Asset Transaction had been effected at undervalue. He attributed values of $192,127,247 for abandonment and reclamation of the Goodyear Wells and $26,831,000 to abandon and reclaim the facilities associated with the Goodyear Wells, for a total ARO value of $218,958,247. He also identified property taxes totalling $10,047,744.20. Net liabilities therefore amounted to $229,005,991, while the net asset value was at most $5,670,200. Based on these numbers, Mr Darby deposed that PEOC had a net negative value of $223,241,000 immediately after the Asset Transaction.

65 Finally, he provided the opinion of the Trustee as to the value of the consideration received and given by PEOC in the Asset Transaction:

> 44. In the opinion of the Trustee:
>
> > 44.1. the Goodyear Assets, transferred to PEOC pursuant to the Asset Transaction, had no positive fair market value at the time of the Asset Transaction, but represented a significant net liability of at least $223,241,000;
> >
> > 44.2. the value of the actual consideration given by PEOC in the Asset Transaction was therefore at least $223,241,000; and
> >
> > 44.3. the value of the actual consideration received by PEOC in the Asset Transaction was at most $5,670,200.

66 Importantly, he recognized the potential double-counting of end-of-life obligations, but found any such effect would be of no consequence to his conclusions:

> the McDaniel Report value of $5,670,200 includes an estimate of abandonment costs for those Goodyear Wells included in the report, as well as estimates for salvage value. For this reason, the amount for ARO included in the schedule, Exhibit N, may be overstated as it has to some extent already been included in the value of some of the Goodyear Wells. The Trustee does not consider this to be material to its analysis.

67 In short, in the Asset Transaction PEOC "paid" over $223 million by assuming debt, and received under $6 million in value in return. The Trustee acknowledged some double-counting of end-of-life obligations, but opined, in effect, that the degree of double-counting could not have closed the $217 million consideration gap that created the transfer at undervalue and net negative value of PEOC. No contrary opinion was in evidence.

68 The chambers judge acknowledged the $5,670,200 figure related to only 26% of the Goodyear Assets, but nonetheless adopted it as their full value on the basis that the Trustee failed to submit further and better evidence: see *Second Chambers*

Decision at footnote 9 and para 252. But the burden of proof was on the Perpetual Defendants as applicants. The Trustee, as respondent on the application, only had to resist summary dismissal of the transfer at undervalue and insolvency elements. Its evidence clearly stated that the value PEOC received in the Asset Transaction was at most $5,670,200; that it "paid" over $220 million; and that the resulting value of PEOC was negative $223,241,000.

69 The respondents assert the chambers judge's adoption of a $5.67 million asset value properly accounted for all end-of-life obligations. To the contrary, his analysis left much of their value unaccounted for. Nothing in his reasons suggests he believed their full value was included in the $5,670,200 and was therefore accounted for on the left-hand side. Had that been his belief, it would have made little sense to devote his analysis to the potential inclusion of end-of-life obligations on the right-hand side.

70 After concluding that the obligations should not fall on the right-hand side, the chambers judge gave no further consideration to the abandonment and reclamation obligations the Trustee had valued at $218,958,247. Accepting that the chambers judge did account for the end-of-life obligations associated with 26% of the wells, the values associated with 74% were excluded. While we do not know the net value of the 74%, the high number of shut-in and abandoned wells among the Goodyear Assets, along with the Trustee's total valuation of end-of-life obligations, suggests it could be a large negative number. The record does not permit us to determine what it is. We cannot conclude the chambers judge's analytical error was of no consequence. The appeal is therefore allowed on the basis of the legal error.

v. Interpretation of "obligations, due and accruing due"

71 The Trustee argues the chambers judge erred in his approach to statutory interpretation when he held the *BIA* was the equivalent of a penal statute and should therefore be interpreted strictly. No party or intervenor seriously defended the chambers judge's approach; nevertheless it merits comment.

72 There is one approach to statutory interpretation. According to the modern principle, the "words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": Rizzo & Rizzo Shoes Ltd (Re), [1998] 1 SCR 27 at para 21, 36 OR (3d) 418. This is consistent with s 12 of the Interpretation Act, RSC 1985, c I–21, which provides that every "enactment is deemed remedial, and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects". The modern approach does not preclude interpreting the words of a statute strictly when that is the most appropriate way to ensure the attainment of its objects, for instance when interpreting an exception to a principle: Alberta Securities Commission v Hennig, 2021 ABCA 411 at para 25.

73 The *BIA* furthers two purposes: to provide for the equitable distribution of a bankrupt's assets among creditors and to facilitate a bankrupt's financial rehabilitation: Alberta (Attorney General) v Moloney, 2015 SCC 51 at para 32; and Husky Oil Operations Ltd v Minister of National Revenue, [1995] 3 SCR 453 at para 7, 128 DLR (4th) 1. Punishment is not among the purposes of the *BIA*. Given the non-penal nature of the *BIA* and the modern principle of interpretation, we are not satisfied that strict construction of s 96 was warranted.

74 We will not comment any further on whether the chambers judge properly interpreted *Century Services Inc v Canada (Attorney General)*, 2010 SCC 60, *Sun Indalex Finance, LLC v United Steelworkers*, 2013 SCC 6, and Stelco Inc., Re2004 CanLII 24933, 48 CBR (4th) 299 (Ont SC) except to point out that at times, various parties to this action have tried to push purposive interpretations of "obligations, due and accruing due" farther than the words can bear. Further, the chambers judge's conclusion that an item must be "completely constituted and presently exigible" to factor into "obligations, due and accruing due" seems unduly narrow.

B. Abuse of Process

75 The Trustee argues the Second Chambers Application constituted an abuse of the court's process in three ways. We agree with the Trustee that the chambers judge erred in agreeing to hear the Second Chambers Application. The Perpetual Defendants' attempt to seek summary dismissal of the same claim a second time, in the absence of any material change, was an abuse of process. The Second Chambers Application should never have been heard. Therefore, rather than returning this

matter for a fresh hearing of the summary dismissal application on the basis of the error in law, we direct the matter to proceed to trial.

76 This finding makes it unnecessary to consider the Trustee's other abuse-of-process arguments in any detail, but we note we would have upheld the chambers judge's decisions on those points.

i. Abuse of process by relitigation

77 At common law, courts have wide discretionary power to prevent their processes from being abused. This power has its roots in a court's inherent and residual discretion to safeguard its authority from being undermined by disruptive, oppressive, or otherwise inappropriate use of court procedures: see the discussion in Behn v Moulton Contracting Ltd, 2013 SCC 26 at para 39 and Adrian Zuckerman, *Zuckerman on Civil Procedure*, 4th ed (London: Sweet & Maxwell, 2021) at 671.

78 The doctrine of abuse of process is flexible, unencumbered by specific requirements and is used in a variety of legal contexts. It engages the "inherent power of the court to prevent the misuse of its procedure, in a way that would be manifestly unfair to a party to the litigation before it or would in some other way bring the administration of justice into disrepute" Toronto (City) v CUPE, Local 79, 2003 SCC 63 at paras 36–37, 42 and *Behn* at para 40.

79 In *CUPE*, the Supreme Court of Canada discussed the differences amongst *res judicata*, abuse of process and collateral attack. While there are some differences between *res judicata* and abuse of process by relitigation, both doctrines are supported by the same rationales, namely "that there be an end to litigation and that no one should be twice vexed by the same cause, . . . to preserve the courts' and the litigants' resources, to uphold the integrity of the legal system in order to avoid inconsistent results, and to protect the principle of finality so crucial to the proper administration of justice": *CUPE* at para 38 citing Donald J Lange, *The Doctrine of Res Judicata in Canada*, (Markham, Ont: Butterworths, 2000) at 347-348.

80 Similarly, the doctrine of abuse of process prevents relitigation of matters where the strict requirements of issue estoppel may not be met, but which would nonetheless violate the principles of judicial economy, consistency, finality, and the integrity of the administration of justice: *CUPE* at para 37. The British Columbia Court of Appeal has also been clear that the doctrines of *res judicata* and merger prevent relitigation of arguments that ought to have been made in the first action: see the discussion in HY Louie Co Limited v. Bowick, 2015 BCCA 256 at paras 62–65.

81 Related to relitigation is the concept of litigation by installment. Alberta courts have held that litigation by installment can constitute an abuse of process and have established a strong policy against it: 385268 BC Ltd v Alberta (Treasury Branches), 2000 CanLII 28273 (Alta QB) at para 29, 267 AR 384, aff'd in 2001 ABCA 289; Robertson v Wasylyshen, 2003 ABCA 279 at para 19; Paramount Energy Operating Corp v Alberta (Energy and Utilities Board), 2004 ABCA 273 at para 26; Arbour Energy Inc v Alberta (Securities Commission), 2009 ABCA 278 at para 25; Enmax Energy Corporation v Alberta Utilities Commission, 2016 ABCA 276 at para 18; Tallcree First Nation v Rath & Company, 2020 ABCA 433 at para 20; and Scott v Alberta Health Services, 2021 ABCA 249 at para 17. The premise of the rule against litigation by installment is that a litigant should not be allowed to have a "second bite at the cherry": Zuckerman at 1368.

82 Underlying these doctrines is the recognition that "parties to an action have a duty to bring their whole case to the court's attention and not to reserve some aspect of the matter against the possibility of a decision in the opponent's favour as a means of preserving a way to come at the opponent again": *H.Y. Louie* at para 63 citing *Wolverton Securities Ltd. v. Schemel*, 2009 BCSC 1048. This duty is a long-standing one and was fully articulated by Wigram V.C. in *Henderson v. Henderson*, (1843), 3 Hare 100 at 114-15, 67 E.R. 313 at 319.

ii. The Second Chambers Application was an abuse of process

83 In the First Chambers Application, the Perpetual Defendants applied under r 7.3 of the Alberta Rules of Court, Alta Reg 124/2010 for summary dismissal of the Trustee's claim for relief under s 96 of the BIA. They chose to argue that only one element of s 96 — whether the parties were at non-arms-length -- was unmeritorious. In the Second Chambers Application, the Perpetual Defendants again applied under r 7.3 for summary dismissal of the Trustee's claim for relief under s 96 of the BIA, this time on the basis that the insolvency and transfer at undervalue elements were unmeritorious. The

Trustee argued this was abusive relitigation.

84 The chambers judge found no abuse of process. He invoked the foundational rules, implying he viewed the Second Chambers Application as an efficient use of court resources. We note that efficiency is not a stand-alone answer to an allegation of abuse of process.

85 The remainder of the chambers judge's reasoning on the relitigation argument was as follows:

> In framing the Perpetual October 2018 Application in an effort to strike and/or dismiss the claim of the Trustee under section 96 of the *BIA*, the Perpetual Defendants focused only on the "arm's length" issue: *PWC QB Reasons* at paras 60 and 90. In contrast, in the Perpetual February 2020 Application, the Perpetual Defendants focus on other elements that the Trustee most prove in order to establish its case. [at para 46]

In effect, he asked himself whether the same argument would be made on both applications.

86 This framing of the question was misdirection. Arguments that could have been made, but were not, are captured by the rationales underlying abuse of process, *res judicata*, issue estoppel, merger, and the jurisprudence prohibiting relitigation and litigation by instalment. The result was to allow the Perpetual Defendants a second shot at the same claim, a practice this Court has consistently discouraged.

87 Rule 7.3(1)(b) permits summary judgment of "all or part of a claim" where "there is no merit to a claim or part of it". If the application is successful, the court may dismiss one or more claims and refer the balance of the claim to trial: r 7(3)(a) and (c). As the words of the section make clear, an application for summary judgment is not an application to resolve a particular question or issue, which would fall under r 7.1. Rather, a r 7(3) claim is meant to determine of the merits of a claim. As set out in Weir-Jones Technical Services Incorporated v Purolator Courier Ltd, 2019 ABCA 49 at para 47, one of the key considerations under r 7.3 is whether the moving party has met the burden to show that there is either "no merit" or "no defence" and that there is no genuine issue requiring a trial. At a threshold level, the facts of the case must be proven on a balance of probabilities, or the application will fail.

88 A successful summary judgment application is a final judgment, subject to appeal. Only unsuccessful summary judgment applications are considered interlocutory. Doctrines such as *res judicata*, issue estoppel and merger do not apply *per se* to interlocutory orders: Kent v Watts, 2019 ABCA 326 at para 23 and cases cited. However, the limited scope of the formal doctrines does not constitute an invitation to relitigate unsuccessful summary judgment applications. We proceed, as other courts have done, on the basis that even if *res judicata* and related doctrines do not apply directly, their rationales influence the abuse of process analysis as applied to unsuccessful summary judgment applications.

89 Serial summary judgment applications were considered by this Court in *Milne v Barnes*, 2013 ABCA 379. At paragraph 6 the Court outlined applicable principles:

> While serial summary judgment applications are obviously to be discouraged, interlocutory applications generally do not create an issue estoppel. A judgment granting summary judgment creates *res judicata*. But, unless it decides a discrete issue that is reflected in the formal judgment, a decision dismissing a summary judgment application generally only decides that on the then existing record there is a "genuine issue for trial". Repeated applications on the same or a similar record are dealt with as an abuse of process, not as an issue estoppel, and are controlled by costs sanctions. Nevertheless, a second application is possible, subject to the court's discretion, for example where brought on a new record, after extensive discoveries, based on an issue not raised or finally determined in the prior application. [citations omitted]

90 The leading authority on whether relitigating an interlocutory application amounts to abuse of process is *Alberta v Pocklington Foods Inc*, 1995 ABCA 111. In November 1991, Alberta refused to produce certain records based on public interest immunity. On application by Pocklington Foods, a chambers judge determined that 105 of them did not need to be produced. Pocklington Foods appealed unsuccessfully. In October 1993, within a few months of receiving the Court of Appeal decision, Pocklington Foods filed another application before the original chambers judge for Alberta to produce the same 105 documents. The chambers judge decided the matter was not *res judicata* and heard the application. Alberta

appealed.

91 The Court of Appeal confirmed *res judicata* and issue estoppel did not apply to the second application; however, that did not mean that courts are powerless to deal with attempts to relitigate issues already decided. A second interlocutory application for the same relief may be permitted where the second application is not truly relitigation. The following factors, listed at paragraph 8, are relevant:

> (a) if the ruling on the first application was not based on the merits of the issue but on a technical objection;
>
> (b) if upon the first application the applicant failed to prove essential facts from mistake or inadvertence;
>
> (c) if there is new evidence that seriously justifies reconsideration of the issue;
>
> (d) if there is a material change of circumstances of a non-evidentiary nature.

Notably absent from this list of exceptions is the wish to advance an argument that could have been made at the first application but was not.

92 With its second application, Pocklington Foods sought the same relief on the same pleadings and material which had earlier resulted in the dismissal of the application. It did not file new evidence deposing to new facts or circumstances or amend its pleadings. It appears the second application was better argued than the first. The Court of Appeal at paragraph 14 set out the rationale for refusing to re-hear applications in these circumstances:

> . . . We do not agree that counsel, having made an application, argued it, and having taken out the order, should be permitted to reargue the application on the basis that this time he might do a better job. It appears to us that to permit a party to reopen a decision on the merits on such a ground would merely encourage counsel to try again and to engage in re-litigation which is unfair to the other party and a waste of the valuable resources of the court. If the first argument failed, then another tactic might work. If the first argument failed before one judge, it might work in a slightly modified form before another. The case against permitting such process becomes even stronger when the party seeking review of the decision has appealed and has been unsuccessful in the appeal. Where the second application seeks only to re-argue the first application, or to make arguments which were available at the time of the first, it should be dismissed as an abuse of the court process, or as frivolous and vexatious. [Emphasis added]

93 *Pocklington Foods* was applied *in Proprietary Industries Inc v Workum*, 2006 ABCA 226. The respondent applied twice to strike an exhibit to an affidavit. At both applications, the allegation was that the exhibit contained hearsay. The same chambers judge dismissed the application the first time but allowed it the second time, noting the respondent had advanced a legal argument not previously made. On the appeal of the second application, this Court overturned the second chambers decision. Nothing new had arisen between the first decision and the second application. "All that was advanced was an additional argument that should have been made on the first occasion. That is exactly what *Pocklington* precludes": at para 7. The Court of Appeal concluded the second application should never have been heard. It reversed the second chambers decision, effectively restoring the result of the first chambers decision.

94 Similar principles can be found in the cases concerning *res judicata* and related doctrines. In Summer Village of Argentia Beach v Warshawski, 1991 ABCA 322 at para 5, this Court held "[*r*]*es judicata* is not limited to what was argued and decided in the previous suit. It extends to what reasonably should then have been raised. Litigation by instalments is interminable." See also Hill v Hill, 2013 ABCA 137 at paras 55–62.

95 The crux of this issue is that the Perpetual Defendants *could have made* their arguments on the insolvency and transfer under value elements in the First Chambers Application, but chose not to. They proceeded with the arms-length argument only, and when that did not work, they tried another tactic to overcome the s 96 claim.

96 It is conceivable that a chambers judge could direct a summary judgment application to be held in stages, delineating certain issues such that the parties are on notice of how and when issues will be determined, but that is not what happened here. It was only after the Perpetual Defendants received the chamber judge's detailed decision in the First Chambers

Application highlighting the strengths and weaknesses in their arguments that they filed the Second Chambers Application.

97 In the First Chambers Application the Perpetual Defendants sought summary dismissal of the s 96 claim and were presumed to have put their best foot forward, yet they provided no explanation as to why the insolvency and transfer at undervalue elements were not challenged in the First Chambers Application. They obtained a judgment, took out an order, launched an appeal and responded to a cross-appeal.

98 In our view, the Second Chambers Application was a blatant attempt to relitigate, making arguments that were available and reasonably should have been made at the First Chambers Application. As set out in *Pocklington* at paragraph 14 it is "unfair to the other party and a waste of the valuable resources of the court" to permit this type of conduct.

99 Finally, the primary focus of the doctrine of abuse of process is to ensure fairness and to preserve the integrity of the courts: *CUPE* at para 43; *Behn* at para 41. Inconsistency of position, and the potential for inconsistent results, are another danger of litigation by slice. This danger is manifest here, since some positions taken by the Perpetual Defendants have changed between the First and Second Chambers Applications.

100 One example is the Perpetual Defendants' change in stance on the acceptability of reserve report valuations, as discussed above. In oral argument, counsel for the Perpetual Defendants explained that they understood the *First Chambers Decision* to mean they should accept the reserve report value.

101 Another example pertains to the level of the analysis and the arms-length issue. In the First Chambers Application, the Perpetual Defendants asserted the transfer should be assessed at the aggregate level, where POC and PEOC were engaged at arms-length with the third-party purchaser. The chambers judge and this Court held the arms-length issue could not be summarily determined. In the Second Chambers Application, the Perpetual Defendants asserted the transfer should be assessed at the asset level, where, in effect, the transaction was even closer than arms-length: there was no "reviewable transfer" under s 96 at all because the Asset Transaction simply redefined the assets as being held by PEOC as trustee for POT to PEOC on its own behalf. In oral argument, counsel for the Perpetual Defendants explained that they learned from the outcome of the *First Chambers Decision* and relaunched the summary dismissal application with a new strategy.

102 These explanations do not dispel the dangers of relitigation and litigation by instalment. They confirm them.

103 The chambers judge erred. This situation is indistinguishable from *Workum*. The question of whether the s 96 claim could be summarily dismissed was foreclosed by the *First Appellate Decision* . The Second Chambers Application was an abuse of process and never should have been heard. As a result, the s 96 claim must proceed to trial.

Conclusion

104 In light of our conclusions, it is unnecessary to consider the remaining grounds of appeal.

105 The appeal is allowed. As set out above, the chambers judge erred in law in his handling of the end-of-life obligations and in allowing the Second Chambers Application to proceed. On the latter basis, and consistent with the *First Appellate Decision* at paragraph 97, we direct the s 96 issue to proceed to trial.

Appeal allowed.

APPENDIX

Date	Step
February 15, 2018	Oral hearing at Supreme Court of Canada on *Redwater*
March 23, 2018	Perpetual/Sequoia assigned itself into bankruptcy and the Trustee was appointed
August 2, 2018	Statement of Claim filed by the Trustee
August 2, 2018	Application for summary judgment and Affidavit of Paul Darby sworn August 2, 2018 filed by the Trustee
August 27, 2018	Statement of Defence filed by the Perpetual Defendants
August 27, 2018	Statement of Defence filed by Ms Rose
August 27, 2018	First Chambers Application filed by the Perpetual Defendants —Application to

	resolve questions and to stay the plaintiff's application filed by the Perpetual Defendants
August 27, 2018	Application to resolve particular question and to stay the plaintiff's application filed by Ms Rose
October 4, 2018	Affidavit of W. Mark Schweitzer sworn October 3, 2018 filed
October 19, 2018	Amended, Amended Application for summary dismissal and striking pleadings and Affidavit of Ms Rose sworn on October 19, 2018 filed by Ms Rose
October 22, 2018	Questioning of Mr Darby on Affidavit sworn August 2, 2018
November 8-9, 2018, and December 17, 2018	Hearing on the First Chambers Application and Ms Rose's application
January 31, 2019	*Redwater* released by the Supreme Court of Canada
June 4, 11 and 14, 2019	Further written submissions on the First Chambers Application and Ms Rose's application
August 15, 2019	Oral reasons (*First Chambers Decision*)
August 23, 2019	Notice of Appeal of the *First Chambers Decision* filed by the Trustee
August 26, 2019	Notice of Appeal of the *First Chambers Decision* filed by the Perpetual Defendants
August 26, 2019	Notice of Appeal of the *First Chambers Decision* filed by the Trustee
September 9, 2019	Notice of Appeal of the *First Chambers Decision* filed by Ms Rose
September 10, 2019	Amended Notice of Appeal of the *First Chambers Decision* filed by the Perpetual Defendants
January 14, 2020	Written reasons (*First Chambers*)
February 25, 2020	Second Chambers Application filed by the Perpetual Defendants
May 5, 2020	Affidavits of W. Mark Schweitzer sworn May 5, 2020 filed
June 30, 2020 to August 17, 2020	Affidavits of representatives for the Orphan Wells Association and Industry Intervenors filed
September 15-16, 2020	Questioning on affiants for Orphan Wells Association and Industry Intervenors
September 23, 2020	Affidavit of Paul Darby sworn September 22, 2020 filed by the Trustee
October 1-2, 2020	Oral hearing on the Second Chambers Application
October 6, 9, 16, 20, 2020	Further written submissions on the Second Chambers Application
December 10, 2020	Oral hearing of the appeal of the *First Chambers Decision*
January 14, 2021	*Second Chambers Decision* released
January 21, 2021	Notice of Appeal of the *Second Chambers Decision* filed by the Trustee
January 25, 2021	*First Appellate Decision* released

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Most Negative Treatment: Recently added (treatment not yet designated)
Most Recent Recently added (treatment not yet designated): Chowdhury v. Exquisite Bay Development Inc. | 2024 ONSC 41, 2024 CarswellOnt 69 | (Ont. S.C.J., Jan 2, 2024)

2004 CarswellOnt 1211
Ontario Superior Court of Justice [Commercial List]

Stelco Inc., Re

2004 CarswellOnt 1211, [2004] O.J. No. 1257, [2004] O.T.C. 284, 129 A.C.W.S. (3d) 1065, 48 C.B.R. (4th) 299

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO STELCO INC. AND THE OTHER APPLICANTS LISTED IN SCHEDULE "A"

APPLICATION UNDER THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

Farley J.

Heard: March 5, 2004
Judgment: March 22, 2004
Docket: 04-CL-5306

Counsel: Michael E. Barrack, James D. Gage, Geoff R. Hall for Applicants
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Ken Rosenberg, Lily Harmer, Rob Centa for United Steelworkers of America
Bob Thornton, Kyla Mahar for Ernst & Young Inc., Monitor of the Applicants
Kevin J. Zych for Informal Committee of Stelco Bondholders
David R. Byers for CIT
Kevin McElcheran for GE
Murray Gold, Andrew Hatnay for Retired Salaried Beneficiaries
Lewis Gottheil for CAW Canada and its Local 523
Virginie Gauthier for Fleet
H. Whiteley for CIBC
Gail Rubenstein for FSCO
Kenneth D. Kraft for EDS Canada Inc.

Subject: Insolvency

Related Abridgment Classifications

Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.7 Miscellaneous

Headnote

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Application of Act

Steel company S Inc. applied for protection under Companies' Creditors Arrangement Act ("CCAA") on January 29, 2004 — Union locals moved to rescind initial order and dismiss initial application of S Inc. and its subsidiaries on ground S Inc. was not "debtor company" as defined in s. 2 of CCAA because S Inc. was not insolvent — Motion dismissed — Given time and steps involved in reorganization, condition of insolvency perforce required expanded meaning under CCAA — Union affiant stated that S Inc. will run out of funding by November 2004 — Given that November was ten months away from date of filing, S Inc. had liquidity problem — S Inc. realistically cannot expect any increase in its credit line with its lenders or access to further outside funding — S Inc. had negative equity of $647 million — On balance of probabilities, S Inc. was insolvent and therefore was "debtor company" as at date of filing and entitled to apply for CCAA protection.

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s. 43(7) — referred to

s. 121(1) — referred to

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s. 2 "debtor company" — referred to

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s. 2 "debtor company" (d) — considered

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s. 12(1) "claim" — referred to

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Words and phrases considered:

debtor company

It seems to me that the [*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36] test of insolvency . . . which I have determined is a proper interpretation is that the [*Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3] definition of [s. 2(1)] (a), (b) or (c) of insolvent person is acceptable with the caveat that as to (a), a financially troubled corporation is insolvent if it is reasonably expected to run out of liquidity within reasonable proximity of time as compared with the time reasonably required to implement a restructuring.

MOTION by union that steel company was not "debtor company" as defined in *Companies' Creditors Arrangement Act*.

***Farley J.*:**

1 As argued this motion by Locals 1005, 5328 and 8782 United Steel Workers of America (collectively "Union") to

rescind the initial order and dismiss the application of Stelco Inc. (”Stelco”) and various of its subsidiaries (collectively “Sub Applicants”) for access to the protection and process of the *Companies' Creditors Arrangement Act* (”CCAA”) was that this access should be denied on the basis that Stelco was not a “debtor company” as defined in s. 2 of the CCAA because it was not insolvent.

2 Allow me to observe that there was a great deal of debate in the materials and submissions as to the reason(s) that Stelco found itself in with respect to what Michael Locker (indicating he was “an expert in the area of corporate restructuring and a leading steel industry analyst”) swore to at paragraph 12 of his affidavit was the “current crisis”:

> 12. Contending with weak operating results and resulting tight cash flow, management has deliberately chosen not to fund its employee benefits. By contrast, Dofasco and certain other steel companies have consistently funded both their employee benefit obligations as well as debt service. If Stelco's management had chosen to fund pension obligations, presumably with borrowed money, *the current crisis* and related restructuring plans would focus on debt restructuring as opposed to the reduction of employee benefits and related liabilities. [Emphasis added.]

3 For the purpose of determining whether Stelco is insolvent and therefore could be considered to be a debtor company, it matters not what the cause or who caused the financial difficulty that Stelco is in as admitted by Locker on behalf of the Union. The management of a corporation could be completely incompetent, inadvertently or advertently; the corporation could be in the grip of ruthless, hard hearted and hard nosed outside financiers; the corporation could be the innocent victim of uncaring policy of a level of government; the employees (unionized or non-unionized) could be completely incompetent, inadvertently or advertently; the relationship of labour and management could be absolutely poisonous; the corporation could be the victim of unforeseen events affecting its viability such a as a fire destroying an essential area of its plant and equipment or of rampaging dumping. One or more or all of these factors (without being exhaustive), whether or not of varying degree and whether or not in combination of some may well have been the cause of a corporation's difficulty. The point here is that Stelco's difficulty exists; the only question is whether Stelco is insolvent within the meaning of that in the “debtor company” definition of the CCAA. However, I would point out, as I did in closing, that no matter how this motion turns out, Stelco does have a problem which has to be addressed - addressed within the CCAA process if Stelco is insolvent or addressed outside that process if Stelco is determined not to be insolvent. The status quo will lead to ruination of Stelco (and its Sub Applicants) and as a result will very badly affect its stakeholder, including pensioners, employees (unionized and non-unionized), management, creditors, suppliers, customers, local and other governments and the local communities. In such situations, time is a precious commodity; it cannot be wasted; no matter how much some would like to take time outs, the clock cannot be stopped. The watchwords of the Commercial List are equally applicable in such circumstances. They are communication, cooperation and common sense. I appreciate that these cases frequently invoke emotions running high and wild; that is understandable on a human basis but it is the considered, rational approach which will solve the problem.

4 The time to determine whether a corporation is insolvent for the purpose of it being a “debtor company” and thus able to make an application to proceed under the CCAA is the date of filing, in this case January 29, 2004.

5 The Monitor did not file a report as to this question of insolvency as it properly advised that it wished to take a neutral role. I understand however, that it did provide some assistance in the preparation of Exhibit C to Hap Steven's affidavit.

6 If I determine in this motion that Stelco is not insolvent, then the initial order would be set aside. See *Montreal Trust Co. of Canada v. Timber Lodge Ltd.* (1992), 15 C.B.R. (3d) 14 (P.E.I. C.A.). The onus is on Stelco as I indicated in my January 29, 2004 endorsement.

7 S. 2 of the CCAA defines “debtor company” as:

> ”debtor company” means any company that:
>
> > (a) is bankrupt or insolvent;
> >
> > (b) has committed an act of bankruptcy within the meaning of *Bankruptcy and Insolvency Act* [”BIA”] or deemed insolvent within the meaning of the *Winding-Up and Restructuring Act*, whether or not proceedings in respect of the company have been taken under either of those Acts;

(c) has made an authorized assignment against which a receiving order has been made under the *Bankruptcy and Insolvency Act*; or

(d) is in the course of being wound-up under the *Winding-Up and Restructuring Act* because the company is insolvent.

8 Counsel for the Existing Stelco Lenders and the DIP Lenders posited that Stelco would be able to qualify under (b) in light of the fact that as of January 29, 2004 whether or not it was entitled to receive the CCAA protection under (a) as being insolvent, it had ceased to pay its pre-filing debts. I would merely observe as I did at the time of the hearing that I do not find this argument attractive in the least. The most that could be said for that is that such game playing would be ill advised and in my view would not be rewarded by the exercise of judicial discretion to allow such an applicant the benefit of a CCAA stay and other advantages of the procedure for if it were capriciously done where there is not reasonable need, then such ought not to be granted. However, I would point out that if a corporation did capriciously do so, then one might well expect a creditor-initiated application so as to take control of the process (including likely the ouster of management including directors who authorized such unnecessary stoppage); in such a case, while the corporation would not likely be successful in a corporation application, it is likely that a creditor application would find favour of judicial discretion.

9 This judicial discretion would be exercised in the same way generally as is the case where s. 43(7) of the BIA comes into play whereby a bankruptcy receiving order which otherwise meets the test may be refused. See *Kenwood Hills Development Inc., Re* (1995), 30 C.B.R. (3d) 44 (Ont. Bktcy.) where at p. 45 I observed:

> The discretion must be exercised judicially based on credible evidence; it should be used according to common sense and justice and in a manner which does not result in an injustice: See *Re Churchill Forest Industries (Manitoba) Ltd.* (1971), 16 C.B.R. (NS) 158 (Man. Q.B.).

10 Anderson J. in *MTM Electric Co., Re* (1982), 42 C.B.R. (N.S.) 29 (Ont. Bktcy.) at p. 30 declined to grant a bankruptcy receiving order for the eminently good sense reason that it would be counterproductive: “Having regard for the value of the enterprise and having regard to the evidence before me, I think it far from clear that a receiving order would confer a benefit on anyone.” This common sense approach to the judicial exercise of discretion may be contrasted by the rather more puzzling approach in *TDM Software Systems Inc., Re* (1986), 60 C.B.R. (N.S.) 92 (Ont. S.C.).

11 The Union, supported by the International United Steel Workers of America (”International”), indicated that if certain of the obligations of Stelco were taken into account in the determination of insolvency, then a very good number of large Canadian corporations would be able to make an application under the CCAA. I am of the view that this concern can be addressed as follows. The test of insolvency is to be determined on its own merits, not on the basis that an otherwise technically insolvent corporation should not be allowed to apply. However, if a technically insolvent corporation were to apply and there was no material advantage to the corporation and its stakeholders (in other words, a pressing need to restructure), then one would expect that the court’s discretion would be judicially exercised against granting CCAA protection and ancillary relief. In the case of Stelco, it is recognized, as discussed above, that it is in crisis and in need of restructuring - which restructuring, if it is insolvent, would be best accomplished within a CCAA proceeding. Further, I am of the view that the track record of CCAA proceedings in this country demonstrates a healthy respect for the fundamental concerns of interested parties and stakeholders. I have consistently observed that much more can be achieved by negotiations outside the courtroom where there is a reasonable exchange of information, views and the exploration of possible solutions and negotiations held on a without prejudice basis than likely can be achieved by resorting to the legal combative atmosphere of the courtroom. A mutual problem requires a mutual solution. The basic interest of the CCAA is to rehabilitate insolvent corporations for the benefit of all stakeholders. To do this, the cause(s) of the insolvency must be fixed on a long term viable basis so that the corporation may be turned around. It is not achieved by positional bargaining in a tug of war between two parties, each trying for a larger slice of a defined size pie; it may be achieved by taking steps involving shorter term equitable sacrifices and implementing sensible approaches to improve productivity to ensure that the pie grows sufficiently for the long term to accommodate the reasonable needs of the parties.

12 It appears that it is a given that the Sub Applicants are in fact insolvent. The question then is whether Stelco is

insolvent.

13 There was a question as to whether Stelco should be restricted to the material in its application as presented to the Court on January 29, 2004. I would observe that CCAA proceedings are not in the nature of the traditional adversarial lawsuit usually found in our courtrooms. It seems to me that it would be doing a disservice to the interest of the CCAA to artificially keep the Court in the dark on such a question. Presumably an otherwise deserving "debtor company" would not be allowed access to a continuing CCAA proceeding that it would be entitled to merely because some potential evidence were excluded for traditional adversarial technical reasons. I would point out that in such a case, there would be no prohibition against such a corporation reapplying (with the additional material) subsequently. In such a case, what would be the advantage for anyone of a "pause" before being able to proceed under the rehabilitative process under the CCAA. On a practical basis, I would note that all too often corporations will wait too long before applying, at least this was a significant problem in the early 1990s. In *Inducon Development Corp., Re* (1991), 8 C.B.R. (3d) 306 (Ont. Gen. Div.), I observed:

> Secondly, CCAA is designed to be remedial; it is not, however, designed to be preventative. CCAA should not be the *last* gasp of a dying company; it should be implemented, if it is to be implemented, at a stage prior to the death throe.

14 It seems to me that the phrase "death throe" could be reasonably replaced with "death spiral". In *Cumberland Trading Inc., Re* (1994), 23 C.B.R. (3d) 225 (Ont. Gen. Div. [Commercial List]), I went on to expand on this at p. 228:

> I would also observe that all too frequently debtors wait until virtually the last moment, the last moment, or in some cases, beyond the last moment before even beginning to think about reorganizational (and the attendant support that any successful reorganization requires from the creditors). I noted the lamentable tendency of debtors to deal with these situations as "last gasp" desperation moves in *Re Inducon Development Corp.* (1992), 8 C.B.R. (3d) 308 (Ont. Gen. Div.). To deal with matters on this basis minimizes the chances of success, even if "success" may have been available with earlier spade work.

15 I have not been able to find in the CCAA reported cases any instance where there has been an objection to a corporation availing itself of the facilities of the CCAA on the basis of whether the corporation was insolvent. Indeed, as indicated above, the major concern here has been that an applicant leaves it so late that the timetable of necessary steps may get impossibly compressed. That is not to say that there have not been objections by parties opposing the application on various other grounds. Prior to the 1992 amendments, there had to be debentures (plural) issued pursuant to a trust deed; I recall that in *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 1 C.B.R. (3d) 101, 1 O.R. (3d) 289 (Ont. C.A.), the initial application was rejected in the morning because there had only been one debenture issued but another one was issued prior to the return to court that afternoon. This case stands for the general proposition that the CCAA should be given a large and liberal interpretation. I should note that there was in *Enterprise Capital Management Inc. v. Semi-Tech Corp.* (1999), 10 C.B.R. (4th) 133 (Ont. S.C.J. [Commercial List]) a determination that in a creditor application, the corporation was found not to be insolvent, but see below as to BIA test (c) my views as to the correctness of this decision.

16 In *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) I observed at p. 32:

> One of the purposes of the CCAA is to facilitate ongoing operations of a business where its assets have a greater value as part of an integrated system than individually. The CCAA facilitates reorganization of a company where the alternative, sale of the property piecemeal, is likely to yield far less satisfaction to the creditors.

17 In *Anvil Range Mining Corp., Re* (2002), 34 C.B.R. (4th) 157 (Ont. C.A.), the court stated to the same effect:

> The second submission is that the plan is contrary to the purposes of the CCAA. Courts have recognized that the purpose of the CCAA is to enable compromises to be made for the common benefit of the creditors and the company and to keep the company alive and out of the hands of liquidators.

18 Encompassed in this is the concept of saving employment if a restructuring will result in a viable enterprise. See

Diemaster Tool Inc. v. Skvortsoff (Trustee of) (1991), 3 C.B.R. (3d) 133 (Ont. Gen. Div.). This concept has been a continuing thread in CCAA cases in this jurisdiction stretching back for at least the past 15 years, if not before.

19 I would also note that the jurisprudence and practical application of the bankruptcy and insolvency regime in place in Canada has been constantly evolving. The early jails of what became Canada were populated to the extent of almost half their capacity by bankrupts. Rehabilitation and a fresh start for the honest but unfortunate debtor came afterwards. Most recently, the *Bankruptcy Act* was revised to the BIA in 1992 to better facilitate the rehabilitative aspect of making a proposal to creditors. At the same time, the CCAA was amended to eliminate the threshold criterion of there having to be debentures issued under a trust deed (this concept was embodied in the CCAA upon its enactment in 1933 with a view that it would only be large companies with public issues of debt securities which could apply). The size restriction was continued as there was now a threshold criterion of at least $5 million of claims against the applicant. While this restriction may appear discriminatory, it does have the practical advantage of taking into account that the costs (administrative costs including professional fees to the applicant, and indeed to the other parties who retain professionals) is a significant amount, even when viewed from the perspective of $5 million. These costs would be prohibitive in a smaller situation. Parliament was mindful of the time horizons involved in proposals under BIA where the maximum length of a proceeding including a stay is six months (including all possible extensions) whereas under CCAA, the length is in the discretion of the court judicially exercised in accordance with the facts and the circumstances of the case. Certainly sooner is better than later. However, it is fair to observe that virtually all CCAA cases which proceed go on for over six months and those with complexity frequently exceed a year.

20 Restructurings are not now limited in practical terms to corporations merely compromising their debts with their creditors in a balance sheet exercise. Rather there has been quite an emphasis recently on operational restructuring as well so that the emerging company will have the benefit of a long term viable fix, all for the benefit of stakeholders. See *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312 (Ont. Gen. Div.) at p. 314 where Borins J. states:

> The proposed plan exemplifies the policy and objectives of the Act as it proposes a regime for the court-supervised re-organization for the Applicant company intended to avoid the devastating social and economic effects of a creditor-initiated termination of its ongoing business operations and enabling the company to carry on its business in a manner in which it is intended to cause the least possible harm to the company, its creditors, its employees and former employees and the communities in which its carries on and carried on its business operations.

21 The CCAA does not define “insolvent” or “insolvency”. Houlden & Morawetz, *The 2004 Annotated Bankruptcy and Insolvency Act* (Toronto, Carswell; 2003) at p. 1107 (N5) states:

> In interpreting “debtor company”, reference must be had to the definition of “insolvent person” in s. 2(1) of the *Bankruptcy and Insolvency Act* . . .
>
> To be able to use the Act, a company must be bankrupt or insolvent: *Reference re Companies' Creditors Arrangement Act (Canada)*, 16 C.B.R. 1, [1934] S.C.R. 659, [1934] 4 D.L.R. 75. The company must, in its application, admit its insolvency.

22 It appears to have become fairly common practice for applicants and others when reference is made to insolvency in the context of the CCAA to refer to the definition of “insolvent person” in the BIA. That definition is as follows:

> s. 2(1) . . .
>
>> ”insolvent person” means a person who is not bankrupt and who resides, carries on business or has property in Canada, and whose liability to creditors provable as claims under this Act amount to one thousand dollars, and
>>
>>> (a) who is for any reason unable to meet his obligations as they generally become due,
>>>
>>> (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or

(c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due.

23 Stelco acknowledges that it does not meet the test of (b); however, it does assert that it meets the test of both (a) and (c). In addition, however, Stelco also indicates that since the CCAA does not have a reference over to the BIA in relation to the (a) definition of "debtor company" as being a company that is "(a) bankrupt or insolvent", then this term of "insolvent" should be given the meaning that the overall context of the CCAA requires. See the modern rule of statutory interpretation which directs the court to take a contextual and purposive approach to the language of the provision at issue as illustrated by *Bell ExpressVu Ltd. Partnership v. Rex*, [2002] 2 S.C.R. 559 (S.C.C.) at p. 580:

> Today there is only one principle or approach, namely the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

24 I note in particular that the (b), (c) and (d) aspects of the definition of "debtor company" all refer to other statutes, including the BIA; (a) does not. S. 12 of the CCAA defines "claims" with reference over to the BIA (and otherwise refers to the BIA and the *Winding-Up and Restructuring Act*). It seems to me that there is merit in considering that the test for insolvency under the CCAA may differ somewhat from that under the BIA, so as to meet the special circumstances of the CCAA and those corporations which would apply under it. In that respect, I am mindful of the above discussion regarding the time that is usually and necessarily (in the circumstances) taken in a CCAA reorganization restructuring which is engaged in coming up with a plan of compromise and arrangement. The BIA definition would appear to have been historically focussed on the question of bankruptcy - and not reorganization of a corporation under a proposal since before 1992, secured creditors could not be forced to compromise their claims, so that in practice there were no reorganizations under the former *Bankruptcy Act* unless all secured creditors voluntarily agreed to have their secured claims compromised. The BIA definition then was essentially useful for being a pre-condition to the "end" situation of a bankruptcy petition or voluntary receiving order where the upshot would be a realization on the bankrupt's assets (not likely involving the business carried on - and certainly not by the bankrupt). Insolvency under the BIA is also important as to the Paulian action events (eg., fraudulent preferences, settlements) as to the conduct of the debtor *prior* to the bankruptcy; similarly as to the question of provincial preference legislation. Reorganization under a plan or proposal, on the contrary, is with a general objective of the applicant continuing to exist, albeit that the CCAA may also be used to have an orderly disposition of the assets and undertaking in whole or in part.

25 It seems to me that given the time and steps involved in a reorganization, and the condition of insolvency perforce requires an expanded meaning under the CCAA. Query whether the definition under the BIA is now sufficient in that light for the allowance of sufficient time to carry through with a realistically viable proposal within the maximum of six months allowed under the BIA? I think it sufficient to note that there would not be much sense in providing for a rehabilitation program of restructuring/reorganization under either statute if the entry test was that the applicant could not apply until a rather late stage of its financial difficulties with the rather automatic result that in situations of complexity of any material degree, the applicant would not have the financial resources sufficient to carry through to hopefully a successful end. This would indeed be contrary to the renewed emphasis of Parliament on "rescues" as exhibited by the 1992 and 1997 amendments to the CCAA and the BIA.

26 Allow me now to examine whether Stelco has been successful in meeting the onus of demonstrating with credible evidence on a common sense basis that it is insolvent within the meaning required by the CCAA in regard to the interpretation of "debtor company" in the context and within the purpose of that legislation. To a similar effect, see *PWA Corp. v. Gemini Group Automated Distribution Systems Inc.* (1993), 103 D.L.R. (4th) 609 (Ont. C.A.), leave to appeal to S.C.C. dismissed [(1993), 49 C.P.R. (3d) ix (S.C.C.)] wherein it was determined that the trial judge was correct in holding that a party was not insolvent and that the statutory definition of insolvency pursuant to the BIA definition was irrelevant to determine that issue, since the agreement in question effectively provided its own definition by implication. It seems to me that the CCAA test of insolvency advocated by Stelco and which I have determined is a proper interpretation is that the BIA

definition of (a), (b) or (c) of insolvent person is acceptable with the caveat that as to (a), a financially troubled corporation is insolvent if it is reasonably expected to run out of liquidity within reasonable proximity of time as compared with the time reasonably required to implement a restructuring. That is, there should be a reasonable cushion, which cushion may be adjusted and indeed become in effect an encroachment depending upon reasonable access to DIP between financing. In the present case, Stelco accepts the view of the Union's affiant, Michael Mackey of Deloitte and Touche that it will otherwise run out of funding by November 2004.

27 On that basis, allow me to determine whether Stelco is insolvent on the basis of (i) what I would refer to as the CCAA test as described immediately above, (ii) BIA test (a) or (iii) BIA test (c). In doing so, I will have to take into account the fact that Stephen, albeit a very experienced and skilled person in the field of restructurings under the CCAA, unfortunately did not appreciate that the material which was given to him in Exhibit E to his affidavit was modified by the caveats in the source material that in effect indicated that based on appraisals, the fair value of the real assets acquired was in excess of the purchase price for two of the U.S. comparators. Therefore the evidence as to these comparators is significantly weakened. In addition at Q. 175-177 in his cross examination, Stephen acknowledged that it was reasonable to assume that a purchaser would "take over some liabilities, some pension liabilities and OPEB liabilities, for workers who remain with the plant." The extent of that assumption was not explored; however, I do note that there was acknowledgement on the part of the Union that such an assumption would also have a reciprocal negative effect on the purchase price.

28 The BIA tests are disjunctive so that anyone meeting any of these tests is determined to be insolvent: see *Optical Recording Laboratories Inc., Re* (1990), 75 D.L.R. (4th) 747 (Ont. C.A.) at p. 756; *Viteway Natural Foods Ltd., Re* (1986), 63 C.B.R. (N.S.) 157 (B.C. S.C.) at p. 161. Thus, if I determine that Stelco is insolvent on *any one* of these tests, then it would be a "debtor company" entitled to apply for protection under the CCAA.

29 In my view, the Union's position that Stelco is not insolvent under BIA (a) because it has not entirely used up its cash and cash facilities (including its credit line), that is, it is not yet as of January 29, 2004 run out of liquidity conflates inappropriately the (a) test with the (b) test. The Union's view would render the (a) test necessarily as being redundant. See *R. v. Proulx*, [2000] 1 S.C.R. 61 (S.C.C.) at p. 85 for the principle that no legislative provision ought to be interpreted in a manner which would "render it mere surplusage." Indeed the plain meaning of the phrase "unable to meet his obligations as they generally become due" requires a construction of test (a) which permits the court to take a purposive assessment of a debtor's ability to meet his future obligations. See *King Petroleum Ltd., Re* (1978), 29 C.B.R. (N.S.) 76 (Ont. S.C.) where Steele J. stated at p. 80:

> With respect to cl. (a), it was argued that at the time the disputed payments were made the company was able to meet its obligations as they generally became due because no major debts were in fact due at that time. This was premised on the fact that the moneys owed to Imperial Oil were not due until 10 days after the receipt of the statements and that the statements had not then been received. I am of the opinion that this is not a proper interpretation of cl. (a). *Clause (a) speaks in the present and future tenses and not in the past*. I am of the opinion that the company was an "insolvent person" within the meaning of cl. (a) because by the very payment-out of the money in question it placed itself in a position that it was unable to meet its obligations as they would generally become due. In other words, it had placed itself in a position that it would not be able to pay the obligations that it knew it had incurred and which it knew would become due in the immediate future. [Emphasis added.]

30 *King Petroleum Ltd.* was a case involving the question in a bankruptcy scenario of whether there was a fraudulent preference during a period when the corporation was insolvent. Under those circumstances, the "immediate future" does not have the same expansive meaning that one would attribute to a time period in a restructuring forward looking situation.

31 Stephen at paragraphs 40-49 addressed the restructuring question in general and its applicability to the Stelco situation. At paragraph 41, he outlined the significant stages as follows:

> The process of restructuring under the CCAA entails a number of different stages, the most significant of which are as follows:
>
> > (a) identification of the debtor's stakeholders and their interests;

(b) arranging for a process of meaningful communication;

(c) dealing with immediate relationship issues arising from a CCAA filing;

(d) sharing information about the issues giving rise to the debtor's need to restructure;

(e) developing restructuring alternatives; and

(f) building a consensus around a plan of restructuring.

32 I note that January 29, 2004 is just 9-10 months away from November 2004. I accept as correct his conclusion based on his experience (and this is in accord with my own objective experience in large and complicated CCAA proceedings) that Stelco would have the liquidity problem within the time horizon indicated. In that regard, I also think it fair to observe that Stelco realistically cannot expect any increase in its credit line with its lenders or access further outside funding. To bridge the gap it must rely upon the stay to give it the uplift as to prefiling liabilities (which the Union misinterpreted as a general turnaround in its cash position without taking into account this uplift). As well, the Union was of the view that recent price increases would relieve Stelco's liquidity problems; however, the answers to undertaking in this respect indicated:

> With respect to the Business Plan, the average spot market sales price per ton was $514, and the average contract business sales price per ton was $599. The Forecast reflects an average spot market sales price per ton of $575, and average contract business sales price per ton of $611. The average spot price used in the forecast considers further announced price increases, recognizing, among other things, the timing and the extent such increases are expected to become effective. The benefit of the increase in sales prices from the Business Plan is essentially offset by the substantial increase in production costs, and in particular in raw material costs, primarily scrap and coke, as well as higher working capital levels and a higher loan balance outstanding on the CIT credit facility as of January 2004.

I accept that this is generally a cancel out or wash in all material respects.

33 I note that $145 million of cash resources had been used from January 1, 2003 to the date of filing. Use of the credit facility of $350 million had increased from $241 million on November 30, 2003 to $293 million on the date of filing. There must be a reasonable reserve of liquidity to take into account day to day, week to week or month to month variances and also provide for unforeseen circumstances such as the breakdown of a piece of vital equipment which would significantly affect production until remedied. Trade credit had been contracting as a result of appreciation by suppliers of Stelco's financial difficulties. The DIP financing of $75 million is only available if Stelco is under CCAA protection. I also note that a shut down as a result of running out of liquidity would be complicated in the case of Stelco and that even if conditions turned around more than reasonably expected, start-up costs would be heavy and quite importantly, there would be a significant erosion of the customer base (reference should be had to the Slater Hamilton plant in this regard). One does not liquidate assets which one would not sell in the ordinary course of business to thereby artificially salvage some liquidity for the purpose of the test: see *Pacific Mobile Corp., Re* (1979), 32 C.B.R. (N.S.) 209 (C.S. Que.) at p. 220. As a rough test, I note that Stelco (albeit on a consolidated basis with all subsidiaries) running significantly behind plan in 2003 from its budget of a profit of $80 million now to a projected loss of $192 million and cash has gone from a positive $209 million to a negative $114 million.

34 Locker made the observation at paragraph 8 of his affidavit that:

> 8. Stelco has performed poorly for the past few years primarily due to an inadequate business strategy, poor utilization of assets, inefficient operations and generally weak management leadership and decision-making. This point is best supported by the fact that Stelco's local competitor, Dofasco, has generated outstanding results in the same period.

Table 1 to his affidavit would demonstrate that Dofasco has had superior profitability and cashflow performance than its "neighbour" Stelco. He went on to observe at paragraphs 36-37:

36. Stelco can achieve significant cost reductions through means other than cutting wages, pensions and benefits

> for employees and retirees. Stelco could bring its cost levels down to those of restructured U.S. mills, with the potential for lowering them below those of many U.S. mills.
>
> 37. Stelco could achieve substantial savings through productivity improvements within the mechanisms of the current collective agreements. More importantly, a major portion of this cost reduction could be achieved through constructive negotiations with the USWA in an out-of-court restructuring that does not require intervention of the courts through the vehicle of CCAA protection.

I accept his constructive comments that there is room for cost reductions and that there are substantial savings to be achieved through productivity improvements. However, I do not see anything detrimental to these discussions and negotiations by having them conducted within the umbrella of a CCAA proceeding. See my comments above regarding the CCAA in practice.

35 But I would observe and I am mystified by Locker's observations at paragraph 12 (quoted above), that Stelco should have borrowed to fund pension obligations to avoid its current financial crisis. This presumes that the borrowed funds would not constitute an obligation to be paid back as to principal and interest, but rather that it would assume the character of a cost-free "gift".

36 I note that Mackey, without the "laundry list" he indicates at paragraph 17 of his second affidavit, is unable to determine at paragraph 19 (for himself) whether Stelco was insolvent. Mackey was unable to avail himself of all available information in light of the Union's refusal to enter into a confidentiality agreement. He does not closely adhere to the BIA tests as they are defined. In the face of positive evidence about an applicant's financial position by an experienced person with expertise, it is not sufficient to displace this evidence by filing evidence which goes no further than raising questions: see *Anvil Range Mining Corp.*, *supra* at p. 162.

37 The Union referred me to one of my decisions *Standard Trustco Ltd. (Trustee of) v. Standard Trust Co.* (1993), 13 O.R. (3d) 7 (Ont. Gen. Div.) where I stated as to the MacGirr affidavit:

> The Trustee's cause of action is premised on MacGirr's opinion that STC was insolvent as at August 3, 1990 and therefore the STC common shares and promissory note received by Trustco in return for the Injection had no value at the time the Injection was made. Further, MacGirr ascribed no value to the opportunity which the Injection gave to Trustco to restore STC and salvage its thought to be existing $74 million investment. In stating his opinion MacGirr defined solvency as:
>
> > (a) the ability to meet liabilities as they fall due; and
> >
> > (b) that assets exceed liabilities.
>
> On cross-examination MacGirr testified that in his opinion on either test STC was insolvent as at August 3, 1990 since as to (a) STC was experiencing then a negative cash flow and as to (b) the STC financial statements incorrectly reflected values. As far as (a) is concerned, I would comment that while I concur with MacGirr that at some time in the long run a company that is experiencing a negative cash flow will eventually not be able to meet liabilities as they fall due but that is not the test (which is a "present exercise"). On that current basis STC was meeting its liabilities on a timely basis.

38 As will be seen from that expanded quote, MacGirr gave his own definitions of insolvency which are not the same as the s. 2 BIA tests (a), (b) and (c) but only a very loose paraphrase of (a) and (c) and an omission of (b). Nor was I referred to the *King Petroleum Ltd.* or *Proulx* cases *supra*. Further, it is obvious from the context that "*sometime in the long run . . . eventually*" is not a finite time in the foreseeable future.

39 I have not given any benefit to the $313 - $363 million of improvements referred to in the affidavit of William Vaughan at paragraph 115 as those appear to be capital expenditures which will have to be accommodated within a plan of arrangement or after emergence.

40 It seems to me that if the BIA (a) test is restrictively dealt with (as per my question to Union counsel as to how far in the future should one look on a prospective basis being answered “24 hours”) then Stelco would not be insolvent under that test. However, I am of the view that that would be unduly restrictive and a proper contextual and purposive interpretation to be given when it is being used for a restructuring purpose even under BIA would be to see whether there is a reasonably foreseeable (at the time of filing) expectation that there is a looming liquidity condition or crisis which will result in the applicant running out of “cash” to pay its debts as they generally become due in the future without the benefit of the say and ancillary protection and procedure by court authorization pursuant to an order. I think this is the more appropriate interpretation of BIA (a) test in the context of a reorganization or “rescue” as opposed to a threshold to bankruptcy consideration or a fraudulent preferences proceeding. On that basis, I would find Stelco insolvent from the date of filing. Even if one were not to give the latter interpretation to the BIA (a) test, clearly for the above reasons and analysis, if one looks at the meaning of “insolvent” within the context of a CCAA reorganization or rescue solely, then of necessity, the time horizon must be such that the liquidity crisis would occur in the sense of running out of “cash” but for the grant of the CCAA order. On that basis Stelco is certainly insolvent given its limited cash resources unused, its need for a cushion, its rate of cash burn recently experienced and anticipated.

41 What about the BIA (c) test which may be roughly referred to as an assets compared with obligations test. See *New Quebec Raglan Mines Ltd. v. Blok-Andersen*, [1993] O.J. No. 727 (Ont. Gen. Div. [Commercial List]) as to fair value and fair market valuation. The Union observed that there was no intention by Stelco to wind itself up or proceed with a sale of some or all of its assets and undertaking and therefore some of the liabilities which Stelco and Stephen took into account would not crystallize. However, as I discussed at the time of the hearing, the (c) test is what one might reasonably call or describe as an “artificial” or notional/hypothetical test. It presumes certain things which are in fact not necessarily contemplated to take place or to be involved. In that respect, I appreciate that it may be difficult to get one’s mind around that concept and down the right avenue of that (c) test. See my views at trial in *Olympia & York Developments Ltd. (Trustee of) v. Olympia & York Realty Corp.*, [2001] O.J. No. 3394 (Ont. S.C.J. [Commercial List]) at paragraphs 13, 21 and 33; affirmed [2003] O.J. No. 5242 (Ont. C.A.). At paragraph 33, I observed in closing:

> 33 . . . They (and their expert witnesses) all had to contend with dealing with rambling and complicated facts and, in Section 100 BIA, a section which is difficult to administer when fmv [fair market value] in a notational or hypothetical market involves ignoring what would often be regarded as self evidence truths but at the same time appreciating that this notational or hypothetical market requires that the objects being sold have to have realistic true to life attributes recognized.

42 The Court of Appeal stated at paragraphs 24-25 as follows:

> 24. Nor are the appellants correct to argue that the trial judge also assumed an imprudent vendor in arriving at his conclusion about the fair market value of the OYSF note would have to know that in order to realize value from the note any purchaser would immediately put OYSF and thus OYDL itself into bankruptcy to pre-empt a subsequent triggering event in favour of EIB. While this was so, and the trial judge clearly understood it, the error in this submission is that it seeks to inject into the analysis factors subjected to the circumstances of OYDL as vendor and not intrinsic to the value of the OYSF note. The calculation of fair market value does not permit this but rather must assume an unconstrained vendor.
>
> 25. The Applicants further argue that the trial judge eroded in determining the fair market value of the OYSF note by reference to a transaction which was entirely speculative because it was never considered by OYDL nor would have it been since it would have resulted in OYDL’s own bankruptcy. I disagree. The transaction hypothesized by the trial judge was one between a notational, willing, prudent and informed vendor and purchaser based on factors relevant to the OYSF note itself rather than the particular circumstances of OYDL as the seller of the note. This is an entirely appropriate way to determine the fair market value of the OYSF note.

43 Test (c) deems a person to be insolvent if “the aggregate of [its] property is not, at a fair valuation, sufficient, or of disposed at a fairly conducted sale under legal process would not be sufficient to enable payment of all [its] obligations, due

and accruing due." The origins of this legislative test appear to be the decision of Spragge V-C in *Davidson v. Douglas* (1868), 15 Gr. 347 (Ont. Ch.) at p. 351 where he stated with respect to the solvency or insolvency of a debtor, the proper course is:

> to see and examine whether all his property, real and personal, be sufficient if presently realized for the payment of his debts, and in this view we must estimate his land, as well as his chattel property, not at what his neighbours or others may consider to be its value, but at what it would bring in the market at a forced sale, or a sale where the seller cannot await his opportunities, but must sell.

44 In *Clarkson v. Sterling* (1887), 14 O.R. 460 (Ont. C.P.) at p. 463, Rose J. indicted that the sale must be fair and reasonable, but that the determination of fairness and reasonableness would depend on the facts of each case.

45 The Union essentially relied on garnishment cases. Because of the provisions relating as to which debts may or may not be garnished, these authorities are of somewhat limited value when dealing with the test (c) question. However I would refer to one of the Union's cases *Bank of Montreal v. I.M. Krisp Foods Ltd.*, [1996] S.J. No. 655 (Sask. C.A.) where it is stated at paragraph 11:

> 11. Few phrases have been as problematic to define as "debt due or accruing due". The Shorter Oxford English Dictionary, 3rd ed. defines "accruing" as "arising in due course", but an examination of English and Canadian authority reveals that not all debts "arising in due course" are permitted to be garnisheed. (See Professor Dunlop's extensive research for his British Columbia Law Reform Commission's Report on Attachment of Debts Act, 1978 at 17 to 29 and is text Creditor-Debtor Law in Canada, 2nd ed. at 374 to 385.)

46 In *Barsi v. Farcas* (1923), [1924] 1 D.L.R. 1154 (Sask. C.A.), Lamont J.A. was cited for his statement at p. 522 of *Webb v. Stenton* (1883), 11 Q.B.D. 518 (Eng. C.A.) that: "an accruing debt, therefore, is a debt not yet actually payable, but a debt which is represented by an existing obligation."

47 Saunders J. noted in *633746 Ontario Inc. (Trustee of) v. Salvati* (1990), 79 C.B.R. (N.S.) 72 (Ont. S.C.) at p. 81 that a sale out of the ordinary course of business would have an adverse effect on that actually realized.

48 There was no suggestion by any of the parties that any of the assets and undertaking would have any enhanced value from that shown on the financial statements prepared according to GAAP.

49 In *King Petroleum Ltd.*, *supra* at p. 81 Steele J. observed:

> To consider the question of insolvency under cl. (c) I must look to the aggregate property of the company and come to a conclusion as to whether or not it would be sufficient to enable payment of all obligations due and accruing due. There are two tests to be applied: First, its fair value and, secondly, its value if disposed of at a fairly conducted sale under legal process. The balance sheet is a starting point, but the evidence relating to the fair value of the assets and what they might realize if disposed of at a fairly conducted sale under legal process must be reviewed in interpreting it. In this case, I find no difficulty in accepting the obligations shown as liabilities because they are known. I have more difficulty with respect to the assets.

50 To my view the preferable interpretation to be given to "sufficient to enable payment of all his obligations, due and accruing due" is to be determined in the context of this test as a whole. What is being put up to satisfy those obligations is the debtor's assets and undertaking *in total*; in other words, the debtor in essence is taken as having sold everything. There would be no residual assets and undertaking to pay off any obligations which would not be encompassed by the phrase "all of his obligations, due and accruing due". Surely, there cannot be "orphan" obligations which are left hanging unsatisfied. It seems to me that the intention of "due and accruing due" was to cover off all obligations of whatever nature or kind and leave nothing in limbo.

51 S. 121(1) and (2) of the BIA, which are incorporated by reference in s. 12 of the CCAA, provide in respect to provable

claims:

> S. 121(1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.
>
> (2) The determination whether a contingent or unliquidated claim is a provable claim and the valuation of such claim shall be made in accordance with s. 135.

52 *Houlden and Morawetz 2004 Annotated supra* at p. 537 (G28(3)) indicates:

> The word "liability" is a very broad one. It includes all obligations to which the bankrupt is subject on the day on which he becomes bankrupt except for contingent and unliquidated claims which are dealt with in s. 121(2).

However contingent and unliquidated claims would be encompassed by the term "obligations".

53 In *Gardner v. Newton* (1916), 29 D.L.R. 276 (Man. K.B.), Mathers C.J.K.B. observed at p. 281 that "contingent claim, that is, a claim which may or may not ripen into a debt, according as some future event does or does not happen." See *A Debtor (No. 64 of 1992), Re*, [1993] 1 W.L.R. 264 (Eng. Ch. Div.) at p. 268 for the definition of a "liquidated sum" which is an amount which can be readily ascertained and hence by corollary an "unliquidated claim" would be one which is not easily ascertained, but will have to be valued. In *Gagnier, Re* (1950), 30 C.B.R. 74 (Ont. S.C.), there appears to be a conflation of not only the (a) test with the (c) test, but also the invocation of the judicial discretion not to grant the receiving order pursuant to a bankruptcy petition, notwithstanding that "[the judge was] unable to find the debtor is bankrupt". The debtor was able to survive the (a) test as he had the practice (accepted by all his suppliers) of providing them with post dated cheques. The (c) test was not a problem since the judge found that his assets should be valued at considerably more than his obligations. However, this case does illustrate that the application of the tests present some difficulties. These difficulties are magnified when one is dealing with something more significantly complex and a great deal larger than a haberdashery store - in the case before us, a giant corporation in which, amongst other things, is engaged in a very competitive history including competition from foreign sources which have recently restructured into more cost efficient structures, having shed certain of their obligations. As well, that is without taking into account that a sale would entail significant transaction costs. Even of greater significance would be the severance and termination payments to employees not continued by the new purchaser. Lastly, it was recognized by everyone at the hearing that Stelco's plants, especially the Hamilton-Hilton works, have extremely high environmental liabilities lurking in the woodwork. Stephen observed that these obligations would be substantial, although not quantified.

54 It is true that there are no appraisals of the plant and equipment nor of the assets and undertaking of Stelco. Given the circumstances of this case and the complexities of the market, one may realistically question whether or not the appraisals would be all that helpful or accurate.

55 I would further observe that in the notional or hypothetical exercise of a sale, then all the obligations which would be triggered by such sale would have to be taken into account.

56 All liabilities, contingent or unliquidated would have to be taken into account. See *King Petroleum Ltd.*, *supra* p. 81; *Salvati*, *supra* pp. 80-1; *Maybank Foods Inc. (Trustee of) v. Provisioners Maritimes Ltd.* (1989), 45 B.L.R. 14 (N.S. T.D.) at p. 29; *Challmie, Re* (1976), 22 C.B.R. (N.S.) 78 (B.C. S.C.), at pp. 81-2. In *Challmie* the debtor ought to have known that his guarantee was very much exposed given the perilous state of his company whose liabilities he had guaranteed. It is interesting to note what was stated in *Maybank Foods Inc. (Trustee of)*, even if it is rather patently obvious. Tidman J. said in respect of the branch of the company at p. 29:

> Mr. MacAdam argues also that the $4.8 million employees' severance obligation was not a liability on January 20, 1986. The *Bankruptcy Act* includes as obligations both those due and accruing due. Although the employees' severance obligation was not due and payable on January 20, 1986 it was an obligation "accruing due". The Toronto facility had

> experienced severe financial difficulties for some time; in fact, it was the major, if not the sole cause, of Maybank's financial difficulties. I believe it is reasonable to conclude that a reasonably astute perspective buyer of the company has a going concern would have considered that obligation on January 20, 1986 and that it would have substantially reduced the price offered by that perspective buyer. Therefore that obligation must be considered as an obligation of the company on January 20, 1986.

57 With the greatest of respect for my colleague, I disagree with the conclusion of Ground J. in *Enterprise Capital Management Inc.*, *supra* as to the approach to be taken to "due and accruing due" when he observed at pp. 139-140:

> It therefore becomes necessary to determine whether the principle amount of the Notes constitutes an obligation "due or accruing due" as of the date of this application.
>
> There is a paucity of helpful authority on the meaning of "accruing due" for purposes of a definition of insolvency. Historically, in 1933, in *P. Lyall & Sons Construction Co. v. Baker*, [1933] O.R. 286 (Ont. C.A.), the Ontario Court of Appeal, in determining a question of set-off under the *Dominion Winding-Up Act* had to determine whether the amount claimed as set-off was a debt due or accruing due to the company in liquidation for purposes of that Act. Marsten J. at pp. 292-293 quoted from Moss J.A. in *Mail Printing Co. v. Clarkson* (1898), 25 O.R. 1 (Ont. C.A.) at p. 8:
>
> > A debt is defined to be a sum of money which is certainly, and at all event, payable without regard to the fact whether it be payable now or at a future time. And an accruing debt is a debt not yet actually payable, but a debt which is represented by an existing obligation: Per Lindley L.J. in *Webb v. Stenton* (1883), 11 Q.D.D. at p. 529.
>
> Whatever relevance such definition may have had for purposes of dealing with claims by and against companies in liquidation under the old winding-up legislation, it is apparent to me that it should not be applied to definitions of insolvency. To include every debt payable at some future date in "accruing due" for the purposes of insolvency tests would render numerous corporations, with long term debt due over a period of years in the future and anticipated to be paid out of future income, "insolvent" for the purposes of the BIA and therefore the CCAA. For the same reason, I do not accept the statement quoted in the Enterprise factum from the decision of the Bankruptcy Court for the Southern District of New York in *Centennial Textiles Inc., Re*, 220 B.R. 165 (U.S.N.Y.D.C. 1998) that "if the present saleable value of assets are less than the amount required to pay existing debt as they mature, the debtor is insolvent". In my view, the obligations, which are to be measured against the fair valuation of a company's property as being obligations due and accruing due, must be limited to obligations currently payable or properly chargeable to the accounting period during which the test is being applied as, for example, a sinking fund payment due within the current year. Black's Law Dictionary defines "accrued liability" as "an obligation or debt which is properly chargeable in a given accounting period, but which is not yet paid or payable". The principal amount of the Notes is neither due nor accruing due in this sense.

58 There appears to be some confusion in this analysis as to "debts" and "obligations", the latter being much broader than debts. Please see above as to my views concerning the floodgates argument under the BIA and CCAA being addressed by judicially exercised discretion even if "otherwise warranted" applications were made. I pause to note that an insolvency test under general corporate litigation need not be and likely is not identical, or indeed similar to that under these insolvency statutes. As well, it is curious to note that the cut off date is the end of the current fiscal period which could have radically different results if there were a calendar fiscal year and the application was variously made in the first week of January, mid-summer or the last day of December. Lastly, see above and below as to my views concerning the proper interpretation of this question of "accruing due".

59 It seems to me that the phrase "accruing due" has been interpreted by the courts as broadly identifying obligations that will "become due". See *Viteway Natural Foods Ltd.* below at pp. 163-4 - at least at some point in the future. Again, I would refer to my conclusion above that *every obligation* of the corporation in the hypothetical or notional sale must be treated as "accruing due" to avoid orphan obligations. In that context, it matters not that a wind-up pension liability may be discharged over 15 years; in a test (c) situation, it is crystallized on the date of the test. See *Optical Recording Laboratories Inc. supra* at pp. 756-7; *Viteway Natural Foods Ltd., Re* (1986), 63 C.B.R. (N.S.) 157 (B.C. S.C.) at pp. 164-63-4; *Consolidated Seed*

Exports Ltd., Re (1986), 62 C.B.R. (N.S.) 156 (B.C. S.C.) at p. 163. In *Consolidated Seed Exports Ltd.*, Spencer J. at pp. 162-3 stated:

> In my opinion, a futures broker is not in that special position. The third definition of "insolvency" may apply to a futures trader at any time even though he has open long positions in the market. Even though Consolidated's long positions were not required to be closed on 10th December, the chance that they might show a profit by March 1981 or even on the following day and thus wipe out Consolidated's cash deficit cannot save it from a condition of insolvency on that day. The circumstances fit precisely within the third definition; if all Consolidated's assets had been sold on that day at a fair value, the proceeds would not have covered its obligations due and accruing due, including its obligations to pay in March 1981 for its long positions in rapeseed. The market prices from day to day establish a fair valuation. . . .
>
> The contract to buy grain at a fixed price at a future time imposes a present obligation upon a trader taking a long position in the futures market to take delivery in exchange for payment at that future time. It is true that in the practice of the market, that obligation is nearly always washed out by buying an offsetting short contract, but until that is done the obligation stands. The trader does not know who will eventually be on the opposite side of his transaction if it is not offset but all transactions are treated as if the clearing house is on the other side. It is a present obligation due at a future time. It is therefore an obligation accruing due within the meaning of the third definition of "insolvency".

60 The possibility of an expectancy of future profits or a change in the market is not sufficient; *Consolidated Seed Exports Ltd.* at p. 162 emphasizes that the test is to be done on that day, the day of filing in the case of an application for reorganization.

61 I see no objection to using Exhibit C to Stephen's affidavit as an aid to review the balance sheet approach to test (c). While Stephen may not have known who prepared Exhibit C, he addressed each of its components in the text of his affidavit and as such he could have mechanically prepared the exhibit himself. He was comfortable with and agreed with each of its components. Stelco's factum at paragraphs 70-1 submits as follows:

> 70. In Exhibit C to his Affidavit, Mr. Stephen addresses a variety of adjustments to the Shareholder's Equity of Stelco necessary to reflect the values of assets and liabilities as would be required to determine whether Stelco met the test of insolvency under Clause C. In cross examination of both Mr. Vaughan and Mr. Stephen only one of these adjustments was challenged - the "Possible Reductions in Capital Assets."
>
> 71. The basis of the challenge was that the comparative sales analysis was flawed. In the submission of Stelco, none of these challenges has any merit. Even if the entire adjustment relating to the value in capital assets is ignored, the remaining adjustments leave Stelco with assets worth over $600 million less than the value of its obligations due and accruing due. This fundamental fact is not challenged.

62 Stelco went on at paragraphs 74-5 of its factum to submit:

> 74. The values relied upon by Mr. Stephen if anything, understate the extent of Stelco's insolvency. As Mr. Stephen has stated, and no one has challenged by affidavit evidence or on cross examination, in a fairly conducted sale under legal process, the value of Stelco's working capital and other assets would be further impaired by: (i) increased environmental liabilities not reflected on the financial statements, (ii) increased pension deficiencies that would be generated on a wind up of the pension plans, (iii) severance and termination claims and (iv) substantial liquidation costs that would be incurred in connection with such a sale.
>
> 75. No one on behalf of the USWA has presented any evidence that the capital assets of Stelco are in excess of book value on a stand alone basis. Certainly no one has suggested that these assets would be in excess of book value if the related environmental legacy costs and collective agreements could not be separated from the assets.

63 Before turning to that exercise, I would also observe that test (c) is also disjunctive. There is an insolvency condition if the total obligation of the debtor exceed either (i) a fair valuation of its assets or (ii) the proceeds of a sale fairly conducted under legal process of its assets.

64 As discussed above and confirmed by Stephen, if there were a sale under legal process, then it would be unlikely, especially in this circumstance that values would be enhanced; in all probability they would be depressed from book value. Stephen took the balance sheet GAAP calculated figure of equity at November 30, 2003 as $804.2 million. From that, he deducted the loss for December 2003 - January 2004 of $17 million to arrive at an equity position of $787.2 million as at the date of filing.

65 From that, he deducted, reasonably in my view, those "booked" assets that would have no value in a test (c) sale namely: (a) $294 million of future income tax recourse which would need taxable income in the future to realize; (b) $57 million for a write-off of the Platemill which is presently hot idled (while Locker observed that it would not be prohibitive in cost to restart production, I note that neither Stephen nor Vaughn were cross examined as to the decision not to do so); and (c) the captialized deferred debt issue expense of $3.2 million which is being written off over time and therefore, truly is a "nothing". This totals $354.2 million so that the excess of value over liabilities before reflecting obligations not included in the financials directly, but which are, substantiated as to category in the notes would be $433 million.

66 On a windup basis, there would be a pension deficiency of $1252 million; however, Stephen conservatively in my view looked at the Mercer actuary calculations on the basis of a going concern finding deficiency of $656 million. If the $1252 million windup figure had been taken, then the picture would have been even bleaker than it is as Stephen has calculated it for test (c) purposes. In addition, there are deferred pension costs of $198.7 million which under GAAP accounting calculations is allowed so as to defer recognition of past bad investment experience, but this has no realizable value. Then there is the question of Employee Future Benefits. These have been calculated as at December 31, 2003 by the Mercer actuary as $909.3 million but only $684 million has been accrued and booked on the financial statements so that there has to be an increased provision of $225.3 million. These off balance sheet adjustments total $1080 million.

67 Taking that last adjustment into account would result in a *negative* equity of ($433 million minus $1080 million) or *negative* $647 million. On that basis without taking into account possible reductions in capital assets as dealt with in the somewhat flawed Exhibit E nor environmental and other costs discussed above, Stelco is insolvent according to the test (c). With respect to Exhibit E, I have not relied on it in any way, but it is entirely likely that a properly calculated Exhibit E would provide comparators (also being sold in the U.S. under legal process in a fairly conducted process) which tend to require a further downward adjustment. Based on test (c), Stelco is significantly, not marginally, under water.

68 In reaching my conclusion as to the negative equity (and I find that Stephen approached that exercise fairly and constructively), please note my comments above regarding the possible assumption of pension obligations by the purchaser being offset by a reduction of the purchase price. The 35% adjustment advocated as to pension and employee benefits in this regard is speculation by the Union. Secondly, the Union emphasized cash flow as being important in evaluation, but it must be remembered that Stelco has been negative cash flow for some time which would make that analysis unreliable and to the detriment of the Union's position. The Union treated the $773 million estimated contribution to the shortfall in the pension deficiency by the Pension Benefits Guarantee Fund as eliminating that as a Stelco obligation. That is not the case however as that Fund would be subrogated to the claims of the employees in that respect with a result that Stelco would remain liable for that $773 million. Lastly, the Union indicated that there should be a $155 million adjustment as to the negative equity in Sub Applicants when calculating Stelco's equity. While Stephen at Q. 181-2 acknowledged that there was no adjustment for that, I agree with him that there ought not to be since Stelco was being examined (and the calculations were based) on an unconsolidated basis, not on a consolidated basis.

69 In the end result, I have concluded on the balance of probabilities that Stelco is insolvent and therefore it is a "debtor company" as at the date of filing and entitled to apply for the CCAA initial order. My conclusion is that (i) BIA test (c) strongly shows Stelco is insolvent; (ii) BIA test (a) demonstrates, to a less certain but sufficient basis, an insolvency and (iii) the "new" CCAA test again strongly supports the conclusion of insolvency. I am further of the opinion that I properly exercised my discretion in granting Stelco and the Sub Applicants the initial order on January 29, 2004 and I would confirm that as of the present date with effect on the date of filing. The Union's motion is therefore dismissed.

70 I appreciate that all the employees (union and non-union alike) and the Union and the International have a justifiable pride in their work and their workplace - and a human concern about what the future holds for them. The pensioners are in the same position. Their respective positions can only be improved by engaging in discussion, an exchange of views and information reasonably advanced and conscientiously listened to and digested, leading to mutual problem solving, ideas and negotiations. Negative attitudes can only lead to the detriment to all stakeholders. Unfortunately there has been some finger pointing on various sides; that should be put behind everyone so that participants in this process can concentrate on the future and not inappropriately dwell on the past. I understand that there have been some discussions and interchange over the past two weeks since the hearing and that is a positive start.

Motion dismissed.

APPENDIX