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EMPTY BANKRUPTCY WIN FOR COMMERCIAL LANDLORD

By Michael L. Cook

Bankruptcy Code "[§]365(d)(4) does not apply to the [purported lease] because it is not a 'true lease,'" held the Second Circuit in *In re Sears Holdings Corporation*, 2024 WL 5113165, *3 (2d Cir. Dec. 16, 2024). In the seventh reported decision covering the purported lease assignment in this case — one from the Supreme Court, three from the Second Circuit, and three from the district court — the Second Circuit apparently ended a multi-year litigation by affirming the district court's decision that the landlord's appeal was "moot for lack of a remedy because, although [that] court [had properly] vacated the assignment and assumption of the lease …, the lease would not revert to [the landlord under Code] §365(d)(4), and that [the landlord] had no alternative remedy." *Id*. at *1, citing *In re Sears Holding Corp.*, 661 B.R. 298 (S.D.N.Y. 2024) (*Sears VI*). According to the Second Circuit, the debtor "neither waived nor forfeited the argument that [§]365(d)(4) did not apply here and … [the district court had properly] return[ed] the lease to the [debtor's estate] outside of the assumption procedures set forth in [Code §]365." *Id*. at **1, 6.

The principal substantive holding in the complex case ultimately turned on the district court's analysis of the purported lease itself, something never considered in the prior three years of the litigation. First, held the Second Circuit, Code §365(d)(4) applies "only to a 'true' or 'bona fide' lease." *Id*. at *3, quoting *Int'l Trade Admin. v. Rensselaer Polytechnic Inst.*, 936 F.2d 744, 748 (2d Cir. 1991) (*RPI*). Focusing "on 'the economic substance of the transaction and not its form,'" the court asked "whether the parties intended to impose obligations and confer rights significantly different from those arising from the ordinary landlord/tenant relationship." *Id*. Because the lessee, the debtor here, may have "assume[d] and discharge[d] many of the risks and obligations ordinarily attributed to the outright ownership of property [e.g., payment of property taxes]," the landlord would gain "an inequitable windfall" if it were able to recover the "leased" property. *Id*. In

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other words, if the debtor effectively owned the property, no “true lease” relationship existed.

The *Sears* case was governed by the Second Circuit’s *RPI* decision, explained the court. The purported lease here “is for a term of 100 years. [The debtor] prepaid its rent for the first thirty years of the lease term, and owed [the landlord] just $10 in annual rent thereafter. … [The debtor] paid taxes and other costs associated with the property [and] could, after fifteen years of operation, cease to operate and sublease any portion of the property, or assign the entire lease, all without [the landlord’s] consent.” *Id*. To allow the landlord to “recapture” the property “over sixty years before the expiration of” the purported lease “would amount to a windfall [and] would be grossly inequitable.” *Id*.

NO WAIVER OR FORFEITURE

The court also rejected the landlord’s argument that the debtor and the proposed assignee of the lease had waived or forfeited the §365(d)(4) issue. On the record here, nothing showed that the debtor and assignee intended to waive their defense of the non-lease issue. *Id*. at *4. Although the parties had stipulated to “an extension of the section 365(d)(4) period to a future date,” they never “affirmatively” stated that Code §365(d)(4) governed. Any “oversight” or “thoughtlessness” was “insufficient to constitute waiver.” *Id*. at *5.

The landlord’s “forfeiture” argument also failed. Before the Second Circuit remanded the case to the district court, 2023 WL7294833 (2d Cir. Nov. 6, 2023), “no one argued the point, and no court mentioned” the true-lease defense. *Id*., quoting *Sears VI*, 661 B.R. at 326. It was neither “necessary” nor “even appropriate” for the debtor and assignee to raise the defense before, said the court. *Id*.

REMEDY

The district court also properly returned the purported lease to the debtor’s estate represented by a Liquidating Trustee. *Id*. at *6. Because the district court had previously vacated the assumption and assignment of the lease, it “end[ed] up where ‘it began — as part of [the debtor’s] bankruptcy estate.’” *Id*.

BACKGROUND OF LITIGATION

The background of this unique commercial lease case is instructive. According to the district court, the “tortured history of this case represents the antithesis of what a bankruptcy is supposed to be: a relatively quick and comprehensive resolution of a debtor’s issues with its creditors.” *Sears VI*, 661 B.R. at 303. In 2023, the Second Circuit, on remand from the U.S. Supreme Court, affirmed the district court’s vacating the assumption and assignment of the lease because the Chapter 11 debtor and its assignee failed to give “adequate assurance of future performance of” the lease “as required by [Code] §365(b)(3)(A),” after the debtor had assigned its lease to Transform Holdco LLC (T). It also directed the district court to decide “whether the appeal should be dismissed for lack of any remedy.” *In re Sears Holding Corp.*, 2023 WL 7294833 (2d Cir. Nov. 6, 2023) (*Sears V*).

MOAC Mall Holdings LLC (M), the shopping center landlord/lessor, had previously objected to the lease assignment because the assignee, T, had not met the Code’s financial condition requirement; M lost in the bankruptcy court, but initially prevailed in the district court on appeal (613 B.R.5); but M lost again in that court on reconsideration (616 B.R 615) and in the Court of Appeals on jurisdictional grounds (2021 WL 5986997). The Supreme Court, however, rejected the Second Circuit’s jurisdictional holding and remanded for a review of the merits of M’s appeal. *MOAC Holdings LLC v. Transform Holdco LLC*, 143 S. Ct. 927, 933 (2023) (“… §363(m) is not a jurisdictional provision.”).

The superficially complicated fact pattern in Sears can be simplified. M was a shopping center landlord who challenged the debtor's lease assignment to T because T failed to provide "the requisite adequate assurance of future performance" required by Code § 365(b)(3) ("similar … financial condition and operating performance" as the debtor when "the debtor became the lessee under the lease"). After the bankruptcy court denied its objection, M initially prevailed on appeal in the district court. *In re Sears Holdings Corp*., 613 B.R. 51 (S.D.N.Y. 2020). In its initial decision, the district court held that T "failed to prove financial and operating similarity between [the debtor] in 1991 [when lease signed] and [T] today, under any standard …." *Id*. at 78. "Congress … decided that only an assignee with a financial condition and an operating performance that resembled the debtor's *ab initio* would provide a shopping center landlord with 'adequate assurance' that the bargain originally struck would be performed by the lease's assignee." *Id*. It further rejected the bankruptcy court's unsupported finding that T was "an entity with equity of $50 million …." *Id*. The evidentiary record failed to meet "the congressionally-mandated standard for providing adequate financial assurance of future lease performance." *Id*. at 79. Because of the inadequate record and erroneous legal analysis, the district court vacated the bankruptcy court's approval of the assignment of the lease to T and remanded for further findings. T then sought a rehearing instead, requiring the district court to dismiss M's appeal on jurisdictional grounds, based on Second Circuit precedent construing Code §363(m) (" … reversal on appeal … of a sale … does not affect validity of … sale … unless … sale stayed pending appeal"). The U.S. Supreme Court, however, held that §363(m) is not jurisdictional, vacated the Second Circuit's affirmance of the district court, and remanded the case to the Second Circuit for a review of the merits. 143 S. Ct. at 305.

The Second Circuit affirmed the district court's initial order of Feb. 27, 2020 on remand. *Sears V*, 2023 WL 7294833 at *1. The substance of the district court's initial decision on the merits was therefore sound and warrants a brief summary.

INITIAL DISTRICT COURT RULING

The requirement that the Chapter 11 debtor in possession here, acting as trustee, provide "adequate assurance of future performance" under Code §365(b)(3), was triggered when it sought to assign the shopping center lease after assuming it. "Adequate assurance of future performance" for shopping center leases includes the following requirements:

- the source of rent must be assured. §365(b)(3)(A);
- the financial condition and operating performance of the assignee must be similar to that of the debtor when the debtor first became lessee, here, in 1991. §365(b)(3)(A);
- any percentage rent will not decline "substantially." §365(b)(3)(B);
- the assignment will be subject to all the provisions in the lease, including radius, location, use, and exclusivity. §365(b)(3)(C); and
- the assignment will not disrupt any tenant mix or balance in the shopping center. §365(b)(3)(D).

These requirements make "it more difficult for a debtor-tenant … to assign" a shopping center lease, shifting the balance of power toward the non-debtor commercial lessor. *See, In re Trak Auto Corp.*, 367 F.3d 237, 245 (4th Cir. 2004) (reversed order ignoring lease's use restriction); *In re Joshua Slocum, Ltd.*, 922 F.2d 1081 (3d Cir. 1990) (provisions in debtor's lease concerning termination and minimum sales not to be removed by bankruptcy court as part of debtor's assumption and assignment of lease).

The Second Circuit in *Sears V* said that the district court's "initial [2020] opinion charted a remedial course it might again consider on remand," while affirming its vacating of the lease assignment. *Id*. at *1. According to the district court, "[e]ither [T] meets the standard in the [lease] or it does not. There has to be a finding, one way or the other, and that finding has to be supported by substantial evidence," reasoned the district court.

613 B.R. at 79. There was no room, moreover, for the bankruptcy court's unsupported "wholly conclusory supposition" that T's financial condition, among other things, satisfied "the mandate of § 365(b)(3)(A)." *Id.*

Ultimate Conclusion

The district court ultimately agreed with the Sears Liquidating Trustee: "this case might well turn out to be Pyrrhic victory for [M]." *Sears VI*, 661 B.R. at 330. Although M had "eliminated from the books an obviously erroneous outlier [jurisdictional] ruling by" the Second Circuit, M ultimately wanted to "recapture" the property it had purportedly leased to Sears. The court protected M from the assignment of the lease to an "ineligible" party and "all defaults" under the lease had been cured long ago. M had "freely made" a bargain with Sears in 1991. Nothing in the Code allows "landlords to improve their position simply because a tenant" seeks bankruptcy relief. *Id*. In the end, M had no "remedy in damages against" the Sears Liquidating Trustee," and M's appeal was thus moot because of no alternative remedy. *Id*. at 328.

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BANKRUPTCY CODE CAN PRESENT SIGNIFICANT RISKS TO LENDERS

By Andrew C. Kassner and Joseph N. Argentina Jr.

We all know the old saying — possession is 90% of the law. Well, this article discusses the other 10% and review two situations where a lender received payments and later was forced to disgorge them. The cases involve two recent court adverse decisions for lenders in contexts often seen in the commercial real estate context. In *In re The West Nottingham Academy in Cecil County,* Case No. 23-13830-MMH, the U.S. Bankruptcy Court for the District of Maryland ordered a lender to refund adequate protection payments made by a debtor during a bankruptcy case because the value of the lender's collateral ultimately proved sufficient to protect the lender. In *In re The Mall at the Galaxy,* Case No. 23-1906, the U.S. Court of Appeals for the Third Circuit affirmed decisions of the bankruptcy court avoiding loan payments made to the lender as constructively fraudulent transfers because the loan proceeds had been given to a third party and provided no value to the borrower-debtor. These opinions illustrate two of the ways the bankruptcy code can present significant risks to lenders even after the lender receives payments in accordance with loan agreements or even a court order.

Lender Ordered to Refund Adequate Protection Payments

According to the opinion, the lender in *West Nottingham Academy* was owed approximately $4,847,700 when the borrower filed for bankruptcy. The debt was secured by first priority lien in all of the debtor's real and personal property, including cash. The value of the collateral was unknown at the time of filing of the case. The Bankruptcy Court entered several orders authorizing the debtor's use of cash collateral including adequate protection payments to the lender. The parties ultimately agreed the value of the collateral was

$10,300,000. After confirmation of the debtor's bankruptcy plan, the reorganized debtor sought a refund of the adequate protection payments that had been made to the lender in order to make the payments required under the plan.

The court began its analysis by finding that it had post-confirmation jurisdiction to decide the debtor's motion because the relief sought was "grounded" in the bankruptcy case and jurisdiction was reserved in the cash collateral and plan confirmation orders. Turning to the merits, the court noted that a Chapter 11 debtor has many tools at its disposal to effectuate its reorganization, including the use of cash collateral on terms and under circumstances that would not be possible outside of bankruptcy. Sections 361, 363 and 364 of the Bankruptcy Code permit a debtor to use cash collateral provided the secured party is given adequate protection of its security interest in the cash. The court wrote, "In general, the nature and extent of any adequate protection depends on the value of the collateral." The goal of adequate protection is to maintain the status quo between the secured creditor and the debtor during the case. The Bankruptcy Code requires a debtor to adequately protect the potential harm suffered by a secured party resulting from the decline in value of the collateral.

The debtor had made the adequate protection payments to the lender as provided in the interim cash collateral orders, but as is typically the case, the orders also expressly reserved the debtor's right to request a refund of the adequate protection payments depending on the outcome of the final hearing on the debtor's motion to use cash collateral. The debtor's property was ultimately worth $10,300,000. The lender's interest in the property was the amount of its $4,847,700 claim against the debtor. As a result, the court found the lender's position was significantly over-secured by the real estate itself, and the lender's interest in the collateral was adequately protected by the significant equity cushion in the property. The court ordered the lender to refund the adequate protection payments made during the case.

Lender Ordered to Refund Loan Payments Plus 12 Years of Prejudgment Interest

The debtor in *The Mall at the Galaxy* was a mall located in Guttenberg, NJ. According to the opinion, the debtor's president (and 90% owner of the mall) and two of his friends held equity stakes in a rubber recycling business. In 2007, a fire damaged the recycling business. The recycling company received a secured loan, which included a condition forbidding a loan from an entity owned by the friends. The mall principal testified that in order to work around this restriction, the mall borrowed $2 million from the entity owned by the friends, and transferred the loan proceeds to the recycling business. The U.S. Bankruptcy Court for the District of New Jersey later found the mall had been used as a conduit for the loan from the lender to the recycling company.

The mall filed a Chapter 11 bankruptcy case in 2010, and the case was subsequently converted to a Chapter 7 liquidation. The Chapter 7 trustee commenced an action in 2012 to recover $592,875 in loan payments the mall had made to the lender, alleging the loan and repayments were fraudulent transfers under Sections 548 and 544 of the Bankruptcy Code and applicable New Jersey law. After years of discovery, the Bankruptcy Court granted summary judgment in favor of the trustee on the issue of reasonably equivalent value, finding the debtor did not receive reasonably equivalent value when it transferred the $2 million loan proceeds to the recycling company. The Bankruptcy Court then conducted a trial on the remaining issues and entered judgment avoiding the pre-bankruptcy transfers from the debtor to the lender.

However, the district court reversed the Bankruptcy Court's holding on reasonably equivalent value, ruling the proper focus should have been on the loan from the lender to the debtor, not the subsequent transfer of the loan proceeds by the debtor to the recycling company. If the debtor was merely a conduit for the loan, then it did not receive any value for the loan from the lender and the loan and transfers would not have been given for reasonably equivalent value. On remand, the Bankruptcy Court found the debtor was a conduit and again entered judgment for the trustee, which included prejudgment interest running from 2012 when the

complaint had been filed. On appeal, the district court affirmed the Bankruptcy Court's decision. The lender appealed to the Third Circuit.

The Third Circuit noted that a transfer is constructively fraudulent if "a party insolvent on the date of a transfer does not receive reasonably equivalent value for that transfer." A court should first consider whether the debtor received any value at all. The value does not need to be direct, tangible or easily quantifiable. If at least some value was received, a court should then look at the totality of the circumstances to determine whether the value was reasonably equivalent to the amount transferred. Courts may consider the fair market value received by the debtor, the arm's length nature of the transaction, and the transferee's good faith. Quoting its prior decisions, the court noted, "reasonably equivalent value is not an esoteric concept: a party receives reasonably equivalent value for what it gives up if it gets 'roughly the value it gave.'" The analysis is conducted from the point of view of the debtor's creditors at the time of the transfer.

In this case, the Bankruptcy Court correctly found the loan conferred less than reasonably equivalent value on the debtor because the debtor and its creditors assumed the repayment obligations for the loan. The lender asserted that the debtor received value in the form of equity ownership in two entities in connection with the loan transaction. However, the lender failed to prove the debtor received those interests or any resulting revenue. The court affirmed the Bankruptcy Court's holding that the debtor did not receive reasonably equivalent value for the loan and that the loan and pre-petition repayments to the lender were constructively fraudulent transfers.

The lender had also appealed the Bankruptcy Court's award of prejudgment interest on the $592,875 loan payments to the lender. The Bankruptcy Court ruled the interest should run from July 30, 2012, the date the trustee filed the complaint. The lender complained that it had been paid only $592,875 on the $2 million loan, resulting in a loss of over $1.4 million. The court rejected that argument, noting the lender had use of the $592,875 for over a decade.

The court reasoned that prejudgment interest is permitted under Section 550 of the Bankruptcy Code, which provides that to the extent a transfer is avoided, "the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property …". The Bankruptcy Code does not expressly provide for prejudgment interest, but courts construe the word "value" in Section 550 as authorizing an interest award. The award of interest is within the sound discretion of the bankruptcy court. However, "discretion must be exercised according to law, which means that prejudgment interest should be awarded unless there is a sound reason not to do so …. Interest in an avoidance action furthers the congressional policies of the Bankruptcy Code by compensating the estate for the time it was without use of the transferred funds." The court noted that gratuitous delay by the party seeking recovery may be grounds for limiting an award of interest. The trustee had not unnecessarily prolonged the litigation against the lender. The litigation had taken so long because of summary judgment motions and discovery disputes, some of which resulted in discovery sanctions against the lender. The Third Circuit affirmed the Bankruptcy Court's award of interest.

CONCLUSION: LENDERS BEWARE

These two decisions provide reminders to lenders in two different and perhaps opposite situations — one where the real estate debtor was rendered insolvent and the other where the debtor was ultimately clearly solvent based on the value of the real estate. In one case, fraudulent transfer laws can be applied in certain instances to lenders where it is clear that the loan transaction was clearly a conduit where the real estate debtor could not support the debt.

In the other, the lender was aware that the interim orders were not a final adjudication that the payments could be retained, and unless there was a final hearing and order providing that the payments could be held and applied by the lender against the loan indebtedness, there was a risk of disgorgement.

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PRAGMATIC POST-*PURDUE* APPROACH BEHIND NJ'S RISE AS STRONG VENUE OPTION FOR CHAPTER 11 CASES

By Joseph J. DiPasquale and Michael R. Herz

One of the key elements of a Chapter 11 plan that bankruptcy courts must tackle is the extent of the plan's releases, including whether a requirement that parties must affirmatively "opt-out" of a plan's releases sufficiently manifests consent to the releases for those that do not opt-out. The U.S. Supreme Court's 2024 decision in *Harrington v. Purdue Pharma* sparked nationwide debate over how consent to third-party releases is addressed in Chapter 11 bankruptcy plans.

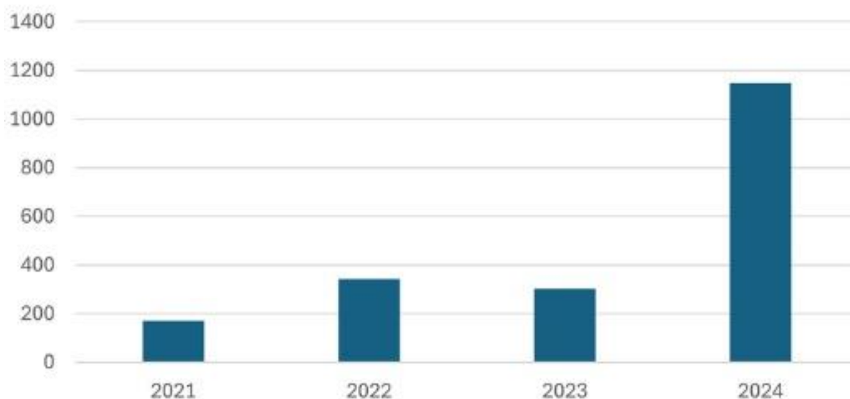
While the Supreme Court clarified that claimants must consent to third-party releases, it left a critical question unanswered: Do release opt-out provisions constitute valid consent?

In the wake of this ambiguity, New Jersey bankruptcy courts have continued their consistent pre-*Purdue* trend of approving opt-out provisions in Chapter 11 plans, emphasizing a pragmatic and flexible approach. This stands in contrast to certain other jurisdictions, including Delaware, where some bankruptcy judges have intensified their scrutiny of plan release language in recent cases and have favored opt-in mechanisms over opt-out provisions to manifest consent.

This consistency in New Jersey in approving opt-outs — even post-*Purdue Pharma* — along with other practical considerations, such as bidding procedures and full DIP roll-ups being approved on day one and efficient management of cases, is why New Jersey has become a hotbed for Chapter 11 bankruptcy filings, including well-known companies such as Rite Aid, WeWork, Bed Bath & Beyond, David's Bridal, Sam Ash and BowFlex, among many others.

In the 12-month period ending Sept. 30, 2024, there were 1,148 Chapter 11 filings in New Jersey — a 575% increase over the 170 Chapter 11 cases in the 12-month period ending Sept. 30, 2021 (see chart below). Compare that to the increase of roughly 60.2% in Chapter 11 filings nationwide in 2024 vis-à-vis 2021.

The Chapter 11 filing statistics clearly show that New Jersey has emerged as a strong venue option. The question is why? The answer, we submit, is consistency and pragmatism.



NEW JERSEY'S DISTINCTIVE APPROACH TO RELEASES

The U.S. Trustee has generally opposed non-debtor third-party releases that rely on opt-out mechanisms, arguing that they do not constitute true consent under applicable case law. Objectors have contended that these provisions unfairly bind creditors who fail to opt out, effectively treating silence as agreement.

Despite these objections, New Jersey bankruptcy courts have repeatedly upheld the validity of opt-out releases, including since the *Purdue Pharma* decision, provided the releases and opt-outs are supported by clear, conspicuous notice and due process. Judges have reasoned that, absent explicit guidance from *Purdue Pharma* on what constitutes consent, the traditional opt-out mechanisms can effectively establish consensual releases under the right circumstances. Since *Purdue Pharma*, the confirmed plans in the *Invitae* (Aug. 2, 2024), *Sam Ash* (Aug. 14, 2024), and *BowFlex* (Aug. 19, 2024) cases all included third-party releases with opt-outs. In *BowFlex*, for example, U.S. Bankruptcy Judge Andrew Altenburg of the District of New Jersey highlighted that *Purdue Pharma* did not define consent in the context of opt-out provisions, concluding that these mechanisms remain appropriate if notice is clear, and the opt-out consequences are fully disclosed.

These cases continue the pre-*Purdue Pharma* trend in New Jersey exhibited in Chapter 11 cases such as *Thrasio* (June 23, 2024), *Cyxtera* (Nov. 17, 2023), *BlockFi* (Oct. 4, 2023), *Bed Bath & Beyond* (Sept. 14, 2023), *Congoleum* (Jan. 5, 2021), *Modell's Sporting Goods* (Nov. 12, 2020), and *SLT Holdco* (Sur La Table) (Oct. 21, 2020). The rare recent exception in New Jersey came in the *Rite Aid* case, where the debtors voluntarily implemented an opt-in release as a strategic choice.

SCOPE OF RELEASES AND GATEKEEPING PROVISIONS

Beyond the question of consent, New Jersey courts have also addressed concerns over the scope of third-party releases, such as whether they can extend to "affiliates" or "related parties" And whether there is mutuality for consideration for third-party releases.

In pre-*Purdue Pharma* cases like *BlockFi* and *Cyxtera*, New Jersey courts approved broad release provisions that included "related parties," and supported by gatekeeping mechanisms that require parties to seek a bankruptcy court ruling before challenging a plan's releases and injunctions in other forums, adding an extra layer of consistency and predictability and avoiding the potential for inconsistent applications by non-bankruptcy courts. While gatekeeping provisions have faced objections from the U.S. Trustee and have not been enough to assuage concerns of some bankruptcy judges in other jurisdictions, New Jersey bankruptcy judges view them as important safeguards to avoid inconsistent interpretations of a plan's release and injunction terms. For instance, in *Cyxtera*, U.S. Bankruptcy Judge John Sherwood noted that the gatekeeping provision was among the facets of that plan that gave him comfort with the plan's third-party releases.

This ongoing tension highlights a key dynamic in Chapter 11 cases that results from the posture of certain parties that will often advocate for stricter limits on third-party releases to protect creditors. Courts in New Jersey successfully balance those concerns against the practical needs of debtors seeking confirmation of their plans.

National Contrasts

New Jersey's flexible stance on third-party releases and the use of opt-outs, particularly post-*Purdue Pharma*, contrasts with several other jurisdictions, including Delaware. A number of recent Delaware rulings have rejected opt-out provisions, requiring affirmative opt-ins to establish valid consent. For instance, in the *Smallhold* (Sept. 25, 2024) case, the bankruptcy court recently found that *Purdue Pharma* limits opt-out releases and that affirmative consent to the releases is required. Previously, in *Aerofarms*, the bankruptcy court found that the inclusion of an opt-out provision, rather than an opt-in, was insufficient to demonstrate consent to the plan's third-party releases. In *Tricida*, the bankruptcy court rejected the proposed opt-out procedure with respect to non-voting interest holders (the plan was ultimately confirmed when the non-voting class was carved out from the third-party releases). In *Reverse Mortgage Funding LLC*, the bankruptcy court ruled that the proposed opt-out mechanism was unworkable.

Similar trends have emerged in other jurisdictions, such as the Southern District of New York (*In re 2u* (Sept. 6, 2024)), the Northern District of New York (*In re Tonawanda Coke Corp.* (Aug. 27, 2024)), the Northern District of Texas (*In re Ebix* (Aug. 2, 2024)), and the Middle District of Florida (*In re Red Lobster* (Sept. 5, 2024)), where courts have increasingly favored opt-in mechanisms following the *Purdue Pharma* decision.

Takeaways

New Jersey bankruptcy courts have demonstrated a consistent and pragmatic framework for handling third-party releases, even in the face of evolving national standards. By upholding opt-out provisions and embracing gatekeeping mechanisms, New Jersey bankruptcy courts offer a flexible and legally sound alternative to more restrictive or unpredictable jurisdictions.

This distinct approach has made New Jersey a preferred venue for Chapter 11 filings, attracting major companies like Rite Aid, WeWork, and Bed Bath & Beyond. As courts across the country continue to grapple with *Purdue Pharma's* implications, New Jersey's consistency provides much-needed clarity for debtors, boards of directors, secured lenders, and creditors alike.

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U.S. TRUSTEE, INSURERS, OBJECT TO J&J'S $10B TALC BANKRUPTCY PLAN

By Amanda Bronstad

The U.S. Trustee and several insurance firms objected to confirmation of Johnson & Johnson's proposed $10 billion bankruptcy plan, citing the U.S. Supreme Court's 2024 ruling that dismantled Purdue Pharma's opioid settlement.

The objections, filed ahead of a key hearing (set for Feb. 18) on whether to confirm the Chapter 11 plan, cite the Supreme Court's decision in *Harrington v. Purdue Pharma*. In that June 27 ruling, the high court, in a 5-4 ruling, invalidated nonconsensual releases in the $6 billion bankruptcy plan granted to Purdue's founders, the Sacklers.

Similar releases exist for Johnson & Johnson in its bankruptcy plan, the objectors say, which is part of a Chapter 11 case filed by its subsidiary, Red River Talc, in U.S. Bankruptcy Court for the Southern District of Texas.

"Like the plan that was disapproved by the Supreme Court in *Purdue*, the release and injunctions in the plan in this case would not only enjoin claims against the debtor, but also claims against numerous entities that have not filed for bankruptcy," U.S. Trustee trial attorney Jayson Ruff wrote in a Jan. 24 objection.

The Coalition of Counsel for Justice for Talc Claimants, in its separate Jan. 24 objection, cited a "list of fatal flaws" with the plan that included the releases granted to Johnson & Johnson and subject to *Purdue*.

"As a former Chief Judge of the Bankruptcy Court, I am particularly troubled by the strategic effort by J&J to take advantage of corporate and bankruptcy laws for the benefit of their shareholders rather than allowing talc claimants to have their day in court before a jury of their peers," Coalition attorney Melanie Cyganowski, of New York's Otterbourg, wrote in a statement. "Our opposition to the proposed plan of reorganization is based on constitutional, statutory and common law arguments."

Travelers Casualty and Surety Co., one of several insurance firms that filed objections, also referenced "bizarre assignment provisions" and releases that violate the law.

"Additionally, the plan contains overbroad, impermissible releases and contemplates the allowance and payment of claims the debtor knows to be fraudulent or otherwise not compensable in the tort system," Travelers attorney Jason Brookner, of Houston's Gray Reed, wrote in a Jan. 24 objection. "Each of these defects will directly harm the insurers."

Following the Supreme Court's *Purdue* decision, attorneys general from 15 states announced last week a new $7.4 billion opioid bankruptcy plan that removed the Sackler releases and added $3.1 billion in funds.

Johnson & Johnson's Worldwide Vice President of Litigation Erik Haas disputed the *Purdue* decision's impact, adding that it actually validated the talc plan.

"The *Purdue* opinion affirms the viability and validity of our consensual pre-packaged bankruptcy reorganization plan by unequivocally endorsing the propriety of third-party releases for asbestos-related bankruptcies," he wrote. "Both the majority and dissent agreed that Congress expressly conferred upon the bankruptcy courts the authority to extinguish asbestos-related claims against debtors and their affiliated third parties where — as we expect in our case — the requisite majority of claimants vote in favor of the reorganization plan."

'UNAUTHORIZED POST-PETITION SOLICITATION'?

Red River's Chapter 11 case began last year after two prior talc bankruptcies filed by another Johnson & Johnson subsidiary, LTL Management, were dismissed.

Purdue is far from the only argument in the objections. The United States of America, in a separate Jan. 24 objection, filing on behalf of the U.S. Department of Health and Human Services, which includes the Centers for Medicare & Medicaid Services, challenged provisions of the plan that appear to discharge the government's rights to pursue reimbursement for paid medical claims.

Many objecting entities made arguments already contained in motions to dismiss the talc bankruptcy, such as allegations of Johnson & Johnson's bad faith and a lack of financial distress on the part of Red River. They also repeated accusations of voting irregularities in the solicitation process that garnered the approval of 83% of talc claimants, according to Johnson & Johnson.

In his objection, Ruff said the U.S. Trustee's Office also was investigating "unauthorized post-petition solicitation of the plan."

"As courts have found under nearly identical circumstances, because no disclosure statement in connection with the plan has been approved, such statements constitute improper post-petition solicitation," Ruff wrote in his objection.

On Jan. 27, he submitted a Dec. 19 email from Johnson & Johnson attorney Jim Murdica, of Barnes & Thornburg in New York, assisting plaintiffs' firms on how to change their vote in support of the plan, which he said had undergone "substantial improvements" since Red River's bankruptcy filing on Sept. 20 of last year. Johnson & Johnson also filed a revised plan on Dec. 9 after several more firms signed up in support.

"The U.S. Trustee is incorrect regarding both the facts and the law," Johnson & Johnson said in a statement about Murdica's email. "More concerning is the U.S. Trustee's repeated alignment with, and advocacy for, the plaintiffs' bar. Notably, she fails to disclose anywhere in her brief that the plaintiffs' lawyers she supports have sent numerous communications post solicitation, which the Trustee only seeks to inculpate when made by the debtors' counsel."

Other firms joined the coalition in opposing plan confirmation, including Barnes Law Group in Marietta, Georgia, and Philadelphia attorney Richard Golomb, of Golomb Legal, who is of counsel to Anapol Weiss.

"As we have been saying from the beginning of the Red River bankruptcy, the J&J plan and tactics, in an attempt to push it through over the objections of thousands and thousands of women, is fraught with irregularities and generally unfair," Golomb told Law.com.

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Amanda Bronstad is an ALM staff reporter, covering class actions and mass torts nationwide. She writes the email dispatch “Law.com Class Actions: Critical Mass.” She is based in Los Angeles.

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NEW YORK BANKRUPTCY JUDGE ALLOWS CASE AGAINST CRYPTO CEO TO MOVE FORWARD

By Michael A. Mora

U.S. Bankruptcy Judge Martin Glenn of the U.S. District Court for the Southern District of New York ruled that a lawsuit, in which the plaintiff alleged that Alex Mashinsky, the founder and ex-CEO of Celsius Network, caused the insolvent crypto lender to incur billions of dollars in damages, can move forward because the terms of the agreement to stay stated that it would be lifted when the litigant’s criminal trial ended.

Alan Rosenberg, a partner at Markowitz Ringel Trusty & Hartog, said that while it is understandable that a criminal defendant such as Mashinsky would not want to litigate simultaneously on multiple fronts, bankruptcy courts are “not receptive to stall tactics.” Rosenberg also suggested that potential Fifth Amendment issues do not necessarily mandate the stay of a civil action during a pending, related criminal proceeding.

“Delays in insolvency proceedings not only frustrate the bankruptcy process, but also increase administrative expenses, which ultimately deplete the recovery for creditors,” said Rosenberg, who is not involved in the matter. “Given Mashinsky’s guilty plea — and thus, the cancellation of the January 28 trial — coupled with the litigation administrators’ agreement to structure the trial schedule to accommodate the TL customers’ concerns, Judge Glenn’s ruling was correct.”

The case dates to mid-2022, when Celsius filed for Chapter 11 protection. The bankruptcy filing left thousands of creditors facing significant financial losses in one of the most high-profile crypto failures to date, court records show. The next year, Mashinsky and other former executives faced indictments for allegedly misleading investors and misappropriating funds.

Meanwhile, Mohsin Y. Meghji of M3 Partners initiated the adversary proceedings as litigation administrator of the post-effective debtors’ estates. The proceedings sought to recover funds transferred to former executives and affiliated entities. However, the U.S. Attorney’s Office for the Southern District of New York requested that the case be stayed multiple times to avoid interfering with the ongoing criminal proceedings.

Following Mashinsky’s guilty plea, the litigation administrator sought to lift the stay and argued that it was no longer necessary to keep it in place because the criminal trial, which was scheduled this month, had been cancelled. The move was supported by prosecutors but opposed by Mashinsky and other defendants, who contended that the stay should remain in place until his sentencing in April.

Mashinsky cited concerns about prejudicing his Fifth Amendment rights and disrupting related civil proceedings, but Glenn rejected these arguments. In doing so, Glenn emphasized that the stay had expired by its own terms, which relied on the conclusion of the criminal jury trial. With the trial cancelled following Mashinsky’s plea, the court found no basis to extend the stay further.

Separately, a coalition of Celsius customers represented by Troutman Pepper Locke and Lowenstein Sandler filed a motion to intervene over fears that the adversary proceeding could prejudice their claims in a separate preference action. Glenn denied this motion, ruling that the customers' concerns were speculative and adequately addressed by the litigation administrator's assurances to coordinate trial schedules.

"Here," Glenn wrote in the opinion, "the Court notes the strong interest of the litigation administrator to move forward with this proceeding to pursue claims for the benefit of the post-effective date debtors' estates that have been on hold for one-and-a-half years."

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Michael A. Mora is a litigation reporter for *Commercial Leasing Law & Strategy*'s ALM sibling Daily Business Review, as well as an editor for ALM Global. Michael was born and raised in South Florida. He went to undergrad at Florida Atlantic University and earned his master's degree from the Columbia University Graduate School of Journalism. He can be reached at mmora@alm.com.

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