

First Circuit finds creditors' committees have unconditional right to intervene in adversary proceedings

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Introduction

On September 22 2017 the First Circuit Court of Appeals held that Section 1109(b) of the Bankruptcy Code provides a creditors' committee with an "unconditional right to intervene" in an adversary proceeding.⁽¹⁾ In reaching this conclusion, the court reversed the District Court for the District of Puerto Rico's order denying an intervention motion and distinguished its own precedent, on which the district court had relied. This decision further bolsters the right of creditors' committees to intervene in and be heard on all matters within a bankruptcy case and positions the First Circuit in line with the Second and Third Circuits, which both have similarly concluded that the code affords an unconditional right to intervene.

Overview

Puerto Rico has been mired in a protracted debt crisis for years. However, unlike US states, Puerto Rico, a US territory, is prohibited from authorising its municipalities to pursue bankruptcy relief under Chapter 9 of the code. In 2014, in an attempt to restructure its overwhelming debt, Puerto Rico fashioned its own municipal insolvency law modelled after Chapter 9. The Supreme Court ultimately rejected the legislation, concluding that it was pre-empted by the code.⁽²⁾ In response, Congress enacted the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA) in 2016.⁽³⁾ PROMESA created a mechanism through which Puerto Rican instrumentalities could pursue quasi-bankruptcy proceedings, referred to as 'Title III', and expressly incorporated large swaths of the code, including the Federal Rules of Bankruptcy Procedure.⁽⁴⁾

On May 3 2017 the PROMESA Financial Oversight and Management Board commenced its debt adjustment case under the statute, which essentially amounted to the filing of a bankruptcy petition.⁽⁵⁾ Certain insurers immediately commenced an adversary proceeding within the Title III case.⁽⁶⁾ The insurers argued that the proposed fiscal plan, approved by the board and recently enacted through Puerto Rican legislation, violated PROMESA and the Constitution.⁽⁷⁾ They sought declaratory and injunctive relief. Shortly thereafter, in June 2017, the Unsecured Creditors Committee (UCC) was appointed.⁽⁸⁾ The UCC immediately filed a motion seeking leave to intervene in the adversary proceeding pursuant to Bankruptcy Rule 7024.⁽⁹⁾ This rule simply provides that Rule 24 of the Federal Rules of Civil Procedure "applies in adversary proceedings". Rule 24 in relevant part provides that "the court must permit anyone to intervene who... is given an unconditional right to intervene by a Federal Statute".⁽¹⁰⁾ The UCC argued that Section 1109(b) of the code conferred precisely such an unconditional right.⁽¹¹⁾ Section 1109(b) of the code provides in relevant part that any 'party in interest' – specifically defined to include a creditors' committee – "may raise and may appear and be heard on any issue in a case under this chapter".⁽¹²⁾ The UCC also

AUTHORS

[Todd E Phillips](#)



[Kevin Maclay](#)



[Sally Sullivan](#)



argued that, in the alternative, it was entitled to permissive intervention under Rule 24(b).(13) The plaintiff insurers opposed the intervention attempt, while the board filed a limited objection.(14)

District court's opinion

The district court denied the UCC's motion to intervene.(15) In reaching its decision, the court relied exclusively on a footnote from the First Circuit's decision in *In re Thompson*, in which the First Circuit stated that Section 1109(b) "does not afford a right to intervene under Rule 24(a)(1)".(16) The district court also rejected the UCC's request for permissive intervention under Rule 24(b).(17)

First Circuit's opinion

In reversing the district court, the First Circuit began by explaining that the footnote on which the district court relied in reaching its conclusion was "pure *dicta*".(18) For this reason, the court explained that it was non-binding; regardless, unlike the district court, the First Circuit "posses[ed] a greater degree of flexibility... with respect to... [its] own precedents".(19) The court explained that *Thompson*, a Chapter 7 case, did not purport to interpret Section 1109(b), which applies only in Chapter 11 proceedings, and instead was predicated on the First Circuit's conclusion that a putative appellant (a non-party) did not have standing to appeal a bankruptcy court order approving settlement of an adversary proceeding.(20)

After establishing that *Thompson* did not control the analysis, the court then considered "afresh whether § 1109(b) confers an unconditional right to intervene in an adversary proceeding".(21) The court concluded that it did based on the plain text of Section 1109(b).(22) In reaching this conclusion, the court joined the Second and Third Circuits, which have similarly found an unconditional right to intervene, and rejected the Fifth Circuit's *Fuel Oil* analysis, which concluded that Section 1109(b) did not apply in adversary proceedings.(23) The court noted that, among other things, since *Fuel Oil* was decided over 30 years ago, the weight of persuasive authority had shifted considerably away from *Fuel Oil*'s holding.(24)

Citing discussion by both the Second and Third Circuits, the First Circuit explained that the statutory language of Section 1109(b) is broad and confers on a creditors' committee the right to "appear and be heard on any issue in a case".(25) The court concluded that Congress intended 'case' to be a "broadly inclusive term" and that as used in the bankruptcy context, 'case' refers to the litigation commenced by the filing of a petition.(26) In contrast, 'proceedings' are particular subsidiary disputes that arise within the larger case.(27) Because Section 1109(b) does not distinguish between different types of proceeding, the statute must apply to all proceedings within the larger bankruptcy case, including adversary proceedings. Since a creditors' committee may be heard on any issue in the overarching case, it may necessarily be heard on any issue in a subsidiary proceeding of that case, such as an adversary proceeding. The court further concluded that "the rights conferred by § 1109(b) are unconditional, as the provision imposes no conditions whatsoever on the ability of a party in interest to raise issues".(28)

However, the court cautioned that its finding of an unconditional right does not "dictate the scope of that participation".(29) The court thus recognised that while the right to intervene is unconditional, it is not an unqualified right. It explained that the "precise scope of... intervention is a matter committed to the district court's 'broad discretion'".(30) Since the district court denied the UCC's motion to intervene, it did not consider the scope of intervention, and for this reason, the court remanded this question to the district court for consideration.

Comment

This ruling further substantiates the robust rights of creditors' committees to participate in all aspects of a bankruptcy case, including adversary proceedings. It also evidences a growing circuit trend toward recognising the existence of an unconditional right to intervene and a rejection of the Fifth Circuit's *Fuel Oil* analysis, which has prevailed for many years.

For further information on this topic please contact [Todd Phillips](mailto:tphillips@capdale.com), [Kevin Maclay](mailto:kmaclay@capdale.com) or [Sally J Sullivan](mailto:ssullivan@capdale.com) at Caplin & Drysdale, Chartered by telephone (+1 202 862 5000) or email (tphillips@capdale.com, kmaclay@capdale.com or ssullivan@capdale.com). The Caplin & Drysdale website can be accessed

Endnotes

(1) *Assured Guar Corp v Fin Oversight and Mgmt Bd For Puerto Rico (In re Financial Oversight and Management Board for Puerto Rico)*, 872 F.3d 57 (1st Cir 2017).

(2) See *Puerto Rico v Franklin California Tax-Free Tr*, 136 S Ct 1938 (2016).

(3) *In re Fin Oversight*, 872 F.3d at 59.

(4) *Id.*

(5) *Id* at 60.

(6) *Id.*

(7) *Id.*

(8) *Id.*

(9) *In re Fin Oversight*, 872 F.3d at 60.

(10) Fed R Civ P 24(a)(1).

(11) *In re Fin Oversight*, 872 F.3d at 60-61.

(12) 11 USC § 1109(b).

(13) *In re Fin Oversight*, 872 F.3d at 60-61.

(14) *Id* at 61.

(15) *Id.*

(16) *Id* (citing *In re Thompson*, 965 F.2d 1136, 1142 n.8 (1st Cir 1992)).

(17) *Id.*

(18) *Id.*

(19) *In re Fin Oversight*, 872 F.3d at 62 (internal quotations omitted).

(20) *Id* at 61-62. In reaching its conclusion, the court noted that "mere participation in a hearing on the approval of a settlement did not constitute *de facto* intervention" and included the footnote discussed above, noting that "similar limitations on participation by 'parties in interest' are recognized elsewhere under the Code", citing Section 1109(b) as an example. *Id* at 62 (internal quotations omitted).

(21) *Id* at 62.

(22) *Id* at 62-63.

(23) *Fuel Oil Supply & Terminaling v Gulf Oil Corp*, 762 F.2d 1283 (5th Cir 1985).

(24) *In re Fin Oversight*, 872 F.3d at 62.

(25) *Id* at 63.

(26) *Id.*

(27) *Id.*

(28) *Id.*

(29) *In re Fin Oversight*, 872 F.3d at 64.

(30) *Id.*

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