Bankruptcy Ruling Affirms High 9th Circ. Evidentiary Standard

By **Brian Shaw** (March 8, 2023)

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In the past year, high-profile bankruptcy cases such as LTL Management LLC[1], Aero Technologies LLC[2] and Purdue Pharma LP[3] have again brought the propriety of using the U.S. Bankruptcy Code to protect affiliated nondebtor entities to the forefront of both the public's and practitioners' minds.

While the high-profile dispute in Purdue Pharma focused on third-party releases proposed in and effectuated through a confirmed Chapter 11 plan of reorganization, LTL's and Aero's third-party protection issues arose — or more accurately were raised by the debtors — at the onset of their bankruptcy cases.

In these cases, the applicable debtor sought to extend the automatic stay to protect affiliated nondebtors from creditor claims, either under Section 362(a) of the Bankruptcy Code[4] or through the application of an injunction entered pursuant to the bankruptcy court's equitable powers under Section 105 of the Bankruptcy Code.[5]

When the debtors in In Re: Mariner Health Central Inc.[6] made such a request to the U.S. Bankruptcy Court for the Northern District of California in September 2022, the Mariner court took the timely opportunity to examine both the prevailing legal and evidentiary standards for such requests in the country's circuit courts of appeal, generally, and within the U.S. Court of Appeals for the Ninth Circuit — and the case at hand — specifically.[7]

And then the Mariner court told the Mariner debtors, "No."[8]

At the onset of their bankruptcy cases, the Mariner debtors asked the bankruptcy court to extend the automatic stay to protect approximately 20 affiliated nondebtor entities, under either Section 362(a)(1) of the Bankruptcy Code[9] or through injunctive relief imposed under Section 105 of the Bankruptcy Code.[10][11]

The nondebtors were codefendants with the debtors in various personal injury and wrongful death actions pending in the California state courts.[12]

The debtors alleged that without the requested extended protection of the Bankruptcy Code, the debtors would be harmed because:

- Ongoing litigation against the nondebtors would require the debtors participation and would hinder their reorganization efforts;
- Unfavorable determinations against the nondebtors would result in indemnification claims against the debtors and their estates; and
- The threat of preclusive effects against the debtors because of the continued discovery and litigation.[13]

Not surprisingly, the plaintiffs in the various California state court lawsuits opposed the extraordinary relief requested by the debtor, arguing not that the extraordinary relief

requested was not available to the debtors as a matter of law, but instead that the debtors failed to meet their evidentiary burden under the controlling law of the Ninth Circuit.[14]

No Unusual Circumstances Test

Before the Mariner court dug into the applicable standard in the Ninth Circuit, it first noted that many courts outside the Ninth Circuit appear to have utilized a somewhat hard-to-define unusual circumstances test to determine whether an extraordinary extension of the automatic stay is warranted.[15]

Such unusual circumstances warranting extraordinary injunctive relief in other circuits have included when claims against a nondebtor, such as a guarantor, could result in a determination of liability against a debtor, or where tort claims against codefendants could result in an apportionment of liability or fault against a debtor.

The Mariner court then noted, however, that the Ninth Circuit "has repeatedly stated [that] the availability of relief by extending the stay due to the purported 'unusual circumstances' test is at best uncertain."[16]

In fact, the Ninth Circuit stated a clear preference that debtors seek such extraordinary relief through the more traditional remedy of traditional injunctive relief.[17]

Accordingly, the Mariner court would only examine the debtors' request as one for injunctive relief and the debtors would have to meet its evidentiary burden and show that:

- They had a reasonable likelihood of success on the merits;
- There was a likelihood of irreparable harm to the debtors if the requested relief was not granted;
- The balance of hardships favors them; and
- Granting the requested relief would further public policy.[18]

An Evidentiary Conundrum

The Mariner court's injunctive relief analysis began where most bankruptcy court's analysis does — by looking at the evidentiary record to determine whether the debtors met their burden and showed the requisite likelihood of success on the merits and irreparable harm — while noting that in bankruptcy cases, the former means the likelihood of a successful reorganization.[19]

The Mariner court also noted that like most courts in its position, it was analyzing the debtors' request for relief against the incomplete record of a newly filed bankruptcy case, which is unfortunate if needed to be relied upon by the debtors to prove either, or both of likelihood of success on the merits and irreparable harm.[20]

The Mariner court continued, stating that this often results in a court's likelihood of success inquiry becoming a search for "any positive signs that the case is off to a reasonably good start" such as "the entry of some first day orders ... and the absence of any obvious signs of misconduct by the debtor, or insurmountable gating issues to confirmation," and a court's irreparable harm test being satisfied by vague, general allegations of irreparable harm.[21]

However, in the Ninth Circuit, the court noted, bankruptcy courts may not rely on these types of generalized, generic claims of harm or success.

Rather, the Ninth Circuit "directs bankruptcy courts to require some particularized evidence of likelihood of plan confirmation/successful reorganization and alleged irreparable harm."[22]

And the evidentiary conundrum? As noted by the Mariner court it is an unfortunate and suboptimal, reality that at the onset of a bankruptcy case, it is very difficult to predict the success of a reorganization or allege future harm with the necessary specificity.[23]

On the other hand, it is also at the onset of the bankruptcy case when the debtor, and its nondebtor affiliates, most often believe they need, and request, extraordinary injunctive relief — only to be left with a suboptimal, incomplete record and insufficient evidence to obtain the requested relief.

The Mariner debtors fell victim to this conundrum, as according to the court, their request for injunctive relief did not contain the requisite detail necessary for the bankruptcy court to grant injunctive relief.[24]

Rather, it only contained generalized allegations of success and harm, neither of which met the burden placed on them by the Ninth Circuit.[25]

Lessons Learned From Mariner

While the Mariner court made clear that its denial of the debtors' request was without prejudice to a future attempt to seek such relief with a more complete record, in all likelihood that opportunity would, in the eyes of the debtor and its affected nondebtor affiliates, be too late to serve their needs or purpose.

And that is the first lesson from Mariner.

If an extension of the automatic stay, or the imposition of injunctive relief to protect nondebtor parties at the onset of the bankruptcy case is a necessary part of the larger restructuring plan, the debtors may not want to voluntarily subject themselves to the higher standard imposed on their request by the Ninth Circuit.

However, there is a more general, important lesson in Mariner that applies to practitioners in any circuit, regardless of the relief requested from the court.

It is not good practice to solely rely on generalized catchphrases and bankruptcy concepts to support any request for any relief, let alone one that is extraordinary by its very nature.

Incomplete record or not, practitioners seeking extraordinary relief from any court should make their own extraordinary effort to present the court as complete of a record as possible.

And if seeking injunctive relief to protect nondebtor parties in the Ninth Circuit, specifically, be aware that a proper evidentiary record and the relief sought may both be illusory.

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[1] Case No. 21-30589, United States Bankruptcy Court for the District of New Jersey.

[2] Case No. 22-02890, et al, United States Bankruptcy Court for the Southern District of Indiana.

[3] Case No. 19-23649, et al, United States Bankruptcy Court for the Southern District of New York.

[4] 11 U.S.C. § 362(a).

[5] 11 U.S.C. § 105.

[6] Case No. 22-41079, et al, United States Bankruptcy Court for the Northern District of California.

[7] Id., D.I. 341, filed January 12, 2023; 2023 WL 187175.

[8] 2023 WL 187175.

[9] 11 U.S.C. § 362(a).

[10] 11 U.S.C. § 105.

[11] 2023 WL 187175, * 1 and 8.

[12] Id., at * 4-5.

[13] Id., at * 8.

[14] Id.

[15] Id., at * 9.

[16] Id., at * 10.

[17] Id.

[18] Id.

[19] Id.

[20] Id, at * 10-11.

[21] Id., at 11.

[22] Id.

[23] Id.

[24] Id., generally.

[25] Id.