Turnarounds & Workouts

MARCH 2023

VOLUME 37, NUMBER 3

News for People Tracking Distressed Businesses

www.TurnaroundsWorkouts.com

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Banking Crisis Over? Experts Are Split

By Christopher Patalinghug

"Above all else, no need to panic," a law professor and restructuring expert tells *Turnarounds & Workouts* regarding the turmoil in the banking sector that saw the collapse of two regional banks. Anthony Michael Sabino, Esq., a Professor in the Department of Law at The Peter J. Tobin College of Business at St. John's University, does not see any far-reaching impact of the recent events, saying Silicon Valley Bank and Signature Bank, which were shuttered by state regulators earlier this month, "occupy a tiny space in the financial ecosystem."

"SVB and Signature represent but a small sliver of the U.S. banking industry, let alone the global banking system," Dr. Sabino says, pointing out the banks were attuned to very specific markets and customers, and are in no way representative of the overall banking system. Indeed, SVB and Signature each has its own specific customer focus, and its own idiosyncratic policies that, more than anything

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Fraud-Discharge Exception Determined by *How*, Not *Who*

By Christopher Patalinghug

In a unanimous 9-0 ruling, the United States Supreme Court held in *Bartenwerfer v. Buckley*, No. 21-908(US), that 11 U.S.C. §523(a)(2)(A) bars debtors from discharging a debt obtained by fraud of the debtor's agent or partner. "[S]ometimes a debtor is liable for fraud that she did not personally commit — for example, deceit practiced by a partner or an agent. We must decide whether the bar extends to this situation too. It does," said the Honorable Justice Amy Coney Barrett, who wrote the decision. According to Justice Barrett, §523(a)(2)(A) turns on how the money was obtained, not who committed fraud to obtain it.

Case Background

In 2005, Kate Bartenwerfer and her then-boyfriend, David Bartenwerfer,

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jointly purchased a house in San Francisco, California. Acting as business partners, they decided to remodel and sell it at a profit. Mr. Bartenwerfer took charge of the renovation. Mrs. Bartenwerfer was largely uninvolved. Shortly following the sale, Buckley discovered several defects the Bartenwerfers had not divulged: a leaky roof, defective windows, a missing fire escape, and permit problems. Buckley sued the Bartenwerfers in California state court, alleging he had overpaid in reliance on their misrepresentations. The jury found in Buckley's favor on his claims for breach of contract, negligence, and nondisclosure of material facts, leaving the Bartenwerfers jointly responsible for more than $200,000 in damages. The Bartenwerfers were unable to pay Buckley, not to mention their other creditors. Seeking relief, they filed for Chapter 7 bankruptcy, which allows debtors to get a "fresh start" by discharging their debts.

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Buckley initiated an adversary proceeding against the Bartenwerfers in the bankruptcy court, arguing that the state court judgment against them could not be discharged in bankruptcy under §523(a)(2)(A), which provides that a debtor cannot discharge debt that was obtained through fraud. The bankruptcy court agreed and held that the portion of the state court judgment that was traceable to Buckley's nondisclosure claim was nondischargeable. The bankruptcy court found that the Bartenwerfers intended to deceive Buckley and held that Mr. Bartenwerfer had actual knowledge of the false representations made to Buckley and that Mr. Bartenwerfer's fraudulent conduct could be imputed onto Mrs. Bartenwerfer because of their partnership relationship. The bankruptcy court declined to apply collateral estoppel in favor of the Bartenwerfers based on the jury's findings of no intentional fraud. On appeal, the Bankruptcy Appellate Panel for the Ninth Circuit affirmed the bankruptcy court's collateral estoppel ruling, but, adopting the Eight Circuit's "knew or should have known" standard from *Walker v. Citizens State Bank*, 726 F.2d 452 (8th Cir. 1984), remanded the imputed liability finding and instructed the bankruptcy court to determine whether Mrs. Bartenwerfer "knew or should have known" of Mr. Bartenwerfer's fraud. After a second bench trial, the bankruptcy court concluded that Mrs. Bartenwerfer lacked the requisite knowledge of her partner's fraud and could therefore discharge her liability to Buckley. The BAP affirmed.

The U.S. Court of Appeals for the Ninth Circuit reversed in relevant part. Invoking the Supreme Court's decision in *Strang v. Bradner*, 114 U.S. 555 (1885), the Ninth Circuit held that a debtor who is liable for her partner's fraud cannot discharge that debt in bankruptcy, regardless of her own culpability, making Mrs. Bartenwerfer on the hook for her debt to Buckley.

The Supreme Court granted certiorari to resolve confusion in the lower courts on the meaning of §523(a)(2)(A).

"We are thrilled by the Supreme Court's decision," said Zachary Tripp, Co-Head of Weil, Gotshal & Manges' Appeals and Strategic Counseling practice, who led the team representing Buckley. "This marks a complete victory for our

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client, Kieran Buckley, who has been fighting to recover his losses since he was defrauded nearly 15 years ago. And it marks an important win for other victims of fraud, as the Court's decision shows the Bankruptcy Code cannot be used as a shield for those who profit from fraud. We are proud to have helped achieve this important result." Janet Brayer of the Law Office of Janet Brayer is Buckley's co-counsel.

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Implications of SC Decision

John Richer, a Partner and Shareholder in the law firm, Hall Estill, observes *Buckley* appears to have significantly expanded what it means to discharge a debt procured by fraud under §523(a)(2)(A). Before *Buckley*, Richer explains, many practitioners and courts required fraudulent conduct or culpability on the part of the debtor in order for the challenging party to successful except the debt from discharge. Now, all that is required is simply showing that the debt was procured by fraud, regardless of who may have committed the fraud," said Richer.

"The Court applied a plain language interpretation of the statue in its ruling," Richer points out. "The case will be particularly relevant and likely limited to its specific facts; that is, joint debtor bankruptcy cases where each debtor is jointly liable on the debt, but only one committed fraudulent conduct in obtaining the debt."

"Under *Buckley*, even if the other joint debtor had nothing to do with obtaining the debt and otherwise engaged in no culpable conduct, the fraud of the debtor that resulted in the procurement of the debt, which the challenging party must still prove, may now be imputed to the innocent joint debtor," Richer added.

Shai Schmidt, a Partner at Glenn Agre Bergman & Fuentes, who spoke to *Turnarounds & Workouts* before the ruling came out, said, "While the issue before the Supreme Court is only directly relevant to individual debtors, the court's ruling may foreshadow how it would deal with other issues that may affect large, corporate Chapter 11 cases." According to Schmidt, if the Supreme Court decides to focus solely on the statutory language instead of extra-statutory policy considerations, that approach could loom large in future cases. "For example, the issue of nonconsensual third-party releases, which is currently on appeal at the Second Circuit in the *Purdue* case and may eventually reach the Supreme Court, may hinge on whether the Bankruptcy Code expressly authorizes the bankruptcy court to approve such releases. The Supreme Court's decision in *Bartenwerfer* may indicate how closely the Supreme Court will adhere to language of the Bankruptcy Code when deciding that issue." ¤

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