Does an Unsecured Creditors’ Committee Have an Absolute Right to Intervene in Adversary Proceedings? The First Circuit Says Yes

By Graham Mitchell

An Official Committee of Unsecured Creditors (“UCC”) often plays an active role in larger, more complex business bankruptcy cases. But what right, if any, does a UCC have to intervene in a bankruptcy adversary proceeding? The First Circuit Court of Appeals recently addressed this very issue in Assured Guaranty Corp., et al. v. The Financial Oversight and Management Board of Puerto Rico, et. al., 17-1831 (1st Cir. Sept. 22, 2017) ("Financial Oversight") and ultimately held that a UCC does have such a right. The opinion furthers an apparent split in the Federal Circuit Courts on this issue. However, as explained below, the First Circuit’s ruling in Financial Oversight is consistent with the more recent, explicit authority.

A. Facts

Financial Oversight arose from litigation related to the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA"), which Congress created in June 2016 to address the ongoing financial crisis in Puerto Rico. Among other things, PROMESA (1) created the Financial Oversight and Management Board ("Board") to oversee economic development, (2) allowed the Board to commence quasi-bankruptcy proceedings, and (3) incorporated most of the United States Bankruptcy Code and the entirety of the Federal Rules of Bankruptcy Procedure.
Specifically, on May 3, 2017, the Board filed quasi-bankruptcy proceedings for the territory of Puerto Rico under PROMESA. The same day, Assured Guaranty Corp. (and other entities that insure Puerto Rico bonds) filed an adversary proceeding against the Board (the “AP”), alleging that a fiscal plan approved by the Board violated PROMESA and was unconstitutional. The UCC appointed in the underlying bankruptcy proceeding filed a motion to intervene in the AP pursuant to Fed. R. Civ. P. 24 (incorporated into the AP by Fed. R. Bankr. P. 7024), which states that a court “must permit anyone to intervene who . . . is given an unconditional right to intervene by statute.” In turn, the UCC argued that it had a statutory right to intervene under Bankruptcy Code Section 1109(b) (which was incorporated into PROMESA), which provided 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 [chapter 11].” On August 10, 2017, the district court denied the UCC’s motion to intervene, citing a footnote from a prior First Circuit Opinion (Kowal v. Malkemus, 964 F.2d 1136, “Kowal”) that stated Section 1109(b) “does not afford a right to intervene under Rule 24(a)(1).” The district court also rejected the UCC’s secondary request for permissive intervention. The UCC appealed to the First Circuit.

B. The First Circuit’s Analysis

The Court began its analysis by disregarding Kowal on the basis that Kowal was factually distinguishable and that the footnote was “pure dicta.” The Court then rejected the reasoning of a Fifth Circuit opinion issued in 1985 (Fuel Oil Supply & Terminaling v. Gulf Oil Corp., 762 F.2d 1283, which held that Section 1109(b) did not apply in adversary proceedings), as well as two other Circuits (the Fourth and Tenth) that indicated agreement with Fuel Oil. Instead, the Court adopted the reasoning of the Second and Third Circuit’s holdings that Section 1109(b) does provide a statutory right to intervene. The Second Circuit’s opinion – the most recent ruling on the issue – conducted an in-depth statutory language analysis that the First Circuit found more persuasive than the reasoning in Fuel Oil. The Court also noted that the Fourth and Tenth Circuit’s apparent agreement with Fuel Oil was in dicta and not explicit, and, therefore, Fuel Oil appeared to be an outlier and went against more recent, direct precedent.

Finally, the Court concluded its analysis by explaining that the fact that the UCC is entitled to intervene does not “dictate the scope of that participation,” and that the district court is entitled to use its broad discretion to determine the ultimate extent of the UCC’s involvement in the AP.

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