

Chapman Client Alert

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Current Issues Relevant to Our Clients

The Seventh Circuit Ups the Ante in an Instructive Decision Affirming the Power of Bankruptcy Courts to Stay Litigation

The successful resolution of disputes arising in bankruptcy proceedings is one of the Bankruptcy Code's (the "*Code*") central objectives. To that end, Section 105(a) of the Code provides that a bankruptcy court "may issue *any* order, process, or judgment that is necessary or appropriate to carry out the provisions of [title 11]." 11 U.S.C. § 105(a) (emphasis added). But does this grant of authority allow a bankruptcy court to stay a lawsuit brought by a non-debtor plaintiff against a non-debtor defendant outside of the bankruptcy case?

The Seventh Circuit Court of Appeals recently held in *In re Caesars Entm't Operating Co., Inc.*, No. 15-3259, 2015 WL 9311432 (7th Cir. December 23, 2015) that a bankruptcy court possesses broad statutory authority under Section 105(a) to stay a separate district court case if the injunction is "likely to enhance the prospects for a successful resolution of the disputes attending [the debtor's] bankruptcy."¹

During its high-stakes corporate life, Caesars Entertainment Operating Company ("*CEOC*") borrowed billions of dollars from a number of lenders to finance its operations (the "*CEOC Loans*"). Caesars Entertainment Corp. ("*CEC*"), the principal owner of CEOC, guaranteed the CEOC Loans. As CEOC's luck began to run out and its losses mounted, CEC sold off CEOC's assets and engaged in a variety of allegedly devious maneuvers in an attempt to terminate its obligations under the guaranties. CEOC's creditors (the "*Guaranty Plaintiffs*") filed a number of lawsuits against CEC challenging CEC's attempts to repudiate its obligations under the guaranties (the "*Guarantor Lawsuits*").² CEOC also separately alleged in its bankruptcy case that CEC fraudulently transferred CEOC's most valuable assets to CEC at less than fair market value in a ploy to ensure that the Guaranty Plaintiffs would be unable to recover what they were owed under the CEOC Loans.

CEOC was betting the house on a substantial settlement contribution from CEC as part of its restructuring plan, and the Guarantor Lawsuits threatened to derail these efforts. As such, CEOC filed a motion in the bankruptcy case to enjoin the Guarantor Lawsuits for 60-days in order to allow a court appointed bankruptcy examiner to complete a report that CEOC argued could assist the parties in negotiating a reorganization of the bankruptcy estate. But the bankruptcy court believed it lacked the authority to enjoin the Guaranty Plaintiffs from proceeding with their lawsuits against non-debtor CEC because the litigation in those matters did not

arise from the "same acts" of CEC that gave rise to the disputes at issue in the bankruptcy proceeding. The bankruptcy court reasoned that the disputes in CEOC's bankruptcy arose from CEC's alleged fraudulent transfers, while the claims brought by the Guaranty Plaintiffs arose from the repudiation of the guaranties they sought to enforce against CEC.

On appeal, the Seventh Circuit reversed, finding that nothing in the text of Section 105(a) limited the power of the bankruptcy court to enjoin the Guarantor Lawsuits. The Court framed the operative question the bankruptcy court failed to address as "whether the injunction sought by CEOC is likely to enhance the prospects for a successful resolution of the disputes attending in its bankruptcy."³ The Court reasoned that if CEC were to be drained of its assets pursuant to judgments entered in the Guarantor Lawsuits, the recovery for CEOC's creditors in the bankruptcy case could be drastically reduced. The Court also noted that the potential injuries to CEOC's creditors and the Guaranty Plaintiffs arising from CEC's scheme to transfer CEOC's assets to itself were not readily separable. Further, the information contained in the bankruptcy examiner's report could provide useful information to help facilitate a successful settlement "of what amounts to a three-cornered battle among CEC, its direct creditors via CEC's guaranties to them, and CEOC's creditors, some of whom are also CEC's creditors by virtue of CEC's guaranteeing CEOC's debts."⁴

The Court also explicitly rejected the Guaranty Plaintiffs' argument that a bankruptcy court may enjoin a separate lawsuit brought by a non-debtor only where the litigation arises out of the "same acts" of the non-debtor that gave rise to disputes in the bankruptcy proceeding. Again affirming the broad mandate of Section 105(a), the Seventh Circuit stated that the issuance of a temporary injunction against a class of

creditors is permissible where it might “facilitate a prompt and orderly wind-up of the bankruptcy.”⁵ The Court distinguished *In re Teknek, LLC*, 563 F.3d 639 (7th Cir. 2009), where the bankruptcy court properly refused to enjoin a party from enforcing a judgment against a non-debtor that engaged in separate acts and caused separate injuries to two separate companies, only one of which was in bankruptcy. In contrast, the alleged misconduct by CEC directly harmed CEOC as well as concerned closely related transactions that sometimes overlapped with those challenged in the bankruptcy.

The Court concluded that because CEOC’s creditors had a “direct and substantial interest” in the Guarantor Lawsuits, and that interest would be furthered by entry of the requested temporary injunction staying the Guarantor Lawsuits, the bankruptcy court possessed the authority to grant such relief. The cause was remanded back to the bankruptcy court for a determination of the factual issue of whether the temporary injunction sought by CEOC was an “appropriate” order under Section 105(a).

While the *In re Caesars* Court correctly noted that Section 105(a) “does not give the bankruptcy court carte blanche,” the case serves as a powerful affirmation of the extensive equitable powers granted to bankruptcy courts under the Code. Bankruptcy courts may be more willing to entertain requests for injunctive relief relating to separate lawsuits against non-debtors if it can be argued that the relief could enhance the prospects for a successful resolution of disputes

in a bankruptcy case. Further, creditors should be on notice that virtually any lawsuit could be unexpectedly thrown off course if the alleged misconduct giving rise to the litigation could adversely impact a bankruptcy estate in a bankruptcy proceeding.

For More Information

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- ¹ *In re Caesars Entm’t Operating Co., Inc.*, No. 15-3259, 2015 WL 9311432, at *4 (7th Cir. December 23, 2015).
 - ² *See, e.g., MeehanCombs Global Credit Opportunities Funds, LP v. Caesars Entertainment Corp.*, 80 F. Supp. 3d 507 (S.D.N.Y. 2015) (alleging that the issuance of supplemental indentures removed CEC’s guaranties and left plaintiffs with a “worthless right” to collect on debt owed by CEOC).
 - ³ *Id.* at 4.
 - ⁴ *Id.* at 5.
 - ⁵ *Id.* at 7.

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