

## **Confirmed Bankruptcy Plan Supersedes Applicable FINRA Rules**

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### **Introduction**

In the United States, the Financial Industry Regulatory Authority (“FINRA”) is authorized by the SEC to adopt and administer the Uniform Practice Code (“UPC”), the rules governing secondary market securities transactions.<sup>1</sup> UPC Rule 1140 determines which unitholders are entitled to a distribution by setting a record date and an ex-date.<sup>2</sup> The record date is the date fixed by the issuer for the purpose of determining which holders of securities are entitled to receive dividends or other distributions.<sup>3</sup> A debtor can also set a record date in their bankruptcy plan.<sup>4</sup> The ex-date is set by FINRA and is “the date on and after which the security is traded without a specific dividend or distribution.”<sup>5</sup>

This memorandum explores the conflict between bankruptcy plans and other applicable law. Part I discusses the *res judicata* effect of confirmed bankruptcy plans. Part II examines the “harmonizing approach” that has been used, and Part III explores a bankruptcy court’s rejection of the harmony approach in *In re Arctic Glacier*.

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<sup>1</sup> *In re THCR/LP Corp.*, No. 04–46898, 2006 WL 530148, at \*4 (D.N.J. Feb. 17, 2006).

<sup>2</sup> *Id.* at \*5.

<sup>3</sup> U.P.C Rule 11120(e).

<sup>4</sup> *In re Arctic Glacier Int’l, Inc.*, No. 12–10605, 2016 WL 3920855, at \*3 (D. Del. Jul. 13, 2016).

<sup>5</sup> *Id.* at \*6.

## I. The *Res Judicata* Effect of Confirmed Bankruptcy Plans

An order confirming a Chapter 11 plan is a final judgment on the merits with respect to the issues addressed in the plan.<sup>6</sup> Confirmation orders bar parties from relitigating provisions of a plan that violate the Bankruptcy Code and non-bankruptcy law.<sup>7</sup> Challenges to a confirmed plan of reorganization alleging that a plan is contrary to applicable law “are bound to be unsuccessful.” *In re Howe*, 913 F.3d 1138, 1143 (5th Cir. 1990). Orders confirming a plan of reorganization can only be revoked if the order was procured by fraud.<sup>8</sup> Subject to the requirements of due process under the Fifth Amendment, a confirmed plan is binding on every entity that holds a claim against or interest in the debtor.<sup>9</sup>

## II. A Confirmed Bankruptcy Plan May be ‘Harmonized’ With Other Applicable Law

In *Karathansis v. THCR/LP Corp.*, the confirmed plan’s record date conflicted with UPC Rule 11140’s ex-date.<sup>10</sup> The record date sets who is entitled to receive dividends, while Rule 11140 sets the date after which securities are traded without a specific dividend.<sup>11</sup> A provision of the confirmed plan called for distributions to be made to stockholders as of the “New Class Warrants Record Date.” The appellants, stockholders as of the record date, sold before the ex-date. Relying on the FINRA ex-date, which is the cutoff for receiving a distribution, the debtor made distributions to the parties who held the stock just before the ex-date—those who purchased from the appellants.

Although the District Court for the District of New Jersey cited precedent that a bankruptcy plan supersedes even when “arguably contrary to applicable law,” the court found

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<sup>6</sup> *Eastern Minerals & Chems. Co. v. Mahan*, 225 F.3d 330, 336 (3d Cir. 2000).

<sup>7</sup> *Stoll v. Gottlieb*, 305 U.S. 165 (1938); *In re Bowen*, 174 B.R. 840, 847 (S.D. Ga. 1994).

<sup>8</sup> *In re Bowen*, 174 B.R. at 847.

<sup>9</sup> *Id.*

<sup>10</sup> *Karathansis v. THCR/LP Corp.*, 2007 WL 1234975, at \*12 (D.N.J. Apr. 25, 2007).

<sup>11</sup> *Id.*

“the Plan and the application of Rule 11140 [ ] can be read in harmony.”<sup>12</sup> That is, the appellants are “still entitled to the Plan distributions,” notwithstanding the purchaser’s right to payment under UPC 11140’s ex-date.<sup>13</sup> In operation, “the net effect of this holding is that the Debtor may have to pay twice.”<sup>14</sup>

### III. Harmonizing Approach Rejected in *In re Arctic Glacier*

In *In re Arctic Glacier*, Arctic Glacier’s confirmed Chapter 15 plan provided that only those who held a claim as of the Plan’s record date would be entitled to receive a dividend.<sup>15</sup> Pursuant to that plan, on January 22, 2015, Arctic Glacier made distributions to those who purchased their securities on or before December 15, 2014, and thus held on the Plan’s record date of December 18, 2014. Plaintiffs, who did not hold their securities until December 19, argued that the FINRA ex-date should govern.<sup>16</sup> The FINRA ex-date was set for January 23, 2015. Therefore, the right to a distribution would not have been cut off until that date—the day after Arctic Glacier made distributions to those who held on the record date.<sup>17</sup> The plaintiffs argued that the FINRA Rules imposed “additional and concurrent obligations” that the debtor was required to meet, thus entitling them to a dividend.<sup>18</sup>

The Bankruptcy Court for the District of Delaware disagreed, finding instead that the Plan and Rules created “conflicting obligations.” Harmonizing the plan and rules was not possible because: (1) “it would impose an obligation on the Monitor that the Monitor did not choose;” and (2) “[i]t would constitute an additional step in the Plan’s distribution procedure,

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<sup>12</sup> *Id.* at \*30.

<sup>13</sup> *Id.* at \*28.

<sup>14</sup> *Id.* at 30.

<sup>15</sup> *Arctic Glacier*, 2016 WL 3920855 at \*3.

<sup>16</sup> *Id.* at \*13.

<sup>17</sup> *Id.* at \*16.

<sup>18</sup> *Id.* at \*13.

something the Plan does not allow.”<sup>19</sup> Because of this conflict, “Defendants were obligated to follow the Plan’s distribution procedure and eschew any conflicting procedure, such as that provided in the FINRA Rules.” *Id.* Therefore, the court held that the plan superseded the FINRA Rules and distributions would be made to unitholders as of the bankruptcy plan’s “Unitholder Distribution Record Date,” and not to the persons who held the units as of FINRA’s ex-date, which fell after the record date.

Key to the court’s finding was the comprehensiveness of the plan. The 30 step distribution plan expressly precluded any authority beyond the plan or court orders.<sup>20</sup> This holding illustrates that even when a confirmed plan conflicts with other law, the plan is still *res judicata* to all issues that could have been adjudicated at the plan hearing.

## **Conclusion**

It is well settled that a confirmed bankruptcy plan is binding on all parties with an interest therein, even if that plan conflicts with other law. A plan and FINRA Rules may be applied in concert in some circumstances. However, where a bankruptcy plan’s distribution procedure is comprehensive, the *res judicata* effect of that plan will bar any claims that a distribution should have been made to a different recipient under the FINRA Rules.

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<sup>19</sup> *Id.* at \*17.

<sup>20</sup> *Id.* at \*2.