

St. John's University School of Law

St. John's Law Scholarship Repository

Bankruptcy Research Library

Center for Bankruptcy Studies

2023

Exceptions to the General Rule that the Automatic Stay Under Bankruptcy Code Section 362(a) Does not Apply to Non-Debtors

Annmarie Gruick

Follow this and additional works at: https://scholarship.law.stjohns.edu/bankruptcy_research_library



Part of the [Bankruptcy Law Commons](#)



**Exceptions to the General Rule that the Automatic Stay Under Bankruptcy Code Section
362(a) Does not Apply to Non-Debtors**

Annmarie Gruick, J.D. Candidate 2024

Cite as: *Exceptions to the General Rule that the Automatic Stay Under Bankruptcy Code Section 362(a) Does not Apply to Non-Debtors*, 15 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 17 (2023).

Introduction

Upon the filing of a bankruptcy petition, the automatic stay takes effect.¹ “The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from its creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him [or her] into bankruptcy.”²

Section 362(a) enumerates eight (8) actions and activities from which the *debtor* is protected—“it does not protect separate legal entities, such as corporate directors, officers or affiliates, partners in a debtor partnership or codefendants in pending litigation.”³ Courts, relying on the explicit construction of section 362(a), have reasoned that the protection is afforded to the debtor alone.⁴

¹ 11 U.S.C. § 362(a) (2018).

² See S. REP. NO. 95-989, at 54–55 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5840–41.

³ 3 COLLIER ON BANKRUPTCY, ¶ 362.03 (Richard Levin & Henry J. Sommer eds. 16th ed. 2022) (emphasis added); see also *Pitts v. Unarco Indus. Inc.*, 698 F.2d 313, 314 (7th Cir. 1983); §§ 362(a)(1)–(8).

⁴ *Williford v. Armstrong World Indus.*, 715 F.2d 124, 126–27 (4th Cir. 1983).

In *A.H. Robins Co. v. Piccinin*,⁵ the Fourth Circuit stated that the automatic stay may be extended to non-bankrupt parties when “unusual circumstances” are present.⁶ The Fourth Circuit has identified two instances rising to the level of “unusual circumstances” warranting an exception to the general rule and application of the automatic stay to non-debtors: (1) where there is such identity between the debtor and third-party defendant that a judgment against the third-party defendant will in effect be a judgment against the debtor; and (2) where the pending litigation, though not brought against the debtor, would cause the debtor irreparable harm.⁷

This article explores the two exceptions to the general rule that the automatic stay does not apply to non-debtors. Part I analyzes the exception recognized when there is both a sufficient and insufficient identity relationship that exists between the debtor and third-party to extend the automatic stay to a non-debtor. Part II analyzes the exception recognized when there is pending litigation brought against a non-debtor which would cause the debtor irreparable harm. Part III analyzes the distinction between extending the automatic stay under section 362 and the often-cited notion of an injunction under section 105 of the Bankruptcy Code prohibiting actions against a non-debtor party.

Discussion

I. The Automatic Stay has Been Extended to a Non-Debtor Third-Party Where There is Such Identity Between the Debtor and Third-Party Defendant that a Judgment Against the Third-Party Defendant Will in Effect be a Judgment Against the Debtor.

A. There is an ‘Identity of Interests’ Sufficient to Extend the Stay to a Non-Debtor Where an Indemnification Agreement Between a Debtor and Non-Debtor Exists.

The court in *A.H. Robins* explained that “unusual circumstances” warranting an extension of the automatic stay to non-debtors are present in the case of “a suit against a third-party who is

⁵ 788 F.2d 994 (4th Cir. 1987).

⁶ *Id.* at 999.

⁷ *Id.*

entitled to absolute indemnity by the debtor or on account of any judgment that might result against them in the case.”⁸ The Fourth Circuit recognized that holding otherwise would upset the underlying purposes of section 362—to protect the debtor and the property of the estate.⁹ The question of extending the stay protections to non-debtors on the theory of indemnification has been often litigated.¹⁰

Courts have continued to rely on the Fourth Circuit’s holding when faced with the question of extending the stay to non-debtors.¹¹ The court in *Philadelphia Newspapers* extended the automatic stay to non-debtors after finding “unusual circumstances” existed.¹² Such “unusual circumstance,” in accord with *A.H. Robins Co.*, was the debtor’s “contractual and common law duties to indemnify the non-debtors,” which included respondeat superior liability, vicarious liability, and principal/agent theories of liability.¹³

More recently, in *LTL Management, LLC*, the bankruptcy court found that the non-debtors and debtor enjoyed such an identity of interests warranting an extension of the stay to the non-debtors.¹⁴ LTL, through a series of pre-petition indemnification agreements, was left responsible for the talc-related liabilities and the bankruptcy court found that this was sufficient to create an identity of interest contemplated by the Fourth Circuit.¹⁵

⁸ *Id.*

⁹ *Id.* (citing *In re The Metal Center*, 31 B.R. 458 (Bankr. D. Conn. 1983)).

¹⁰ *See e.g.*, *Seybolt v. Bio-Energy of Lincoln, Inc.*, 38 B.R. 123, 127–28 (Bankr. D. Mass. 1984) (granting extension of the stay to non-debtor guarantor because of possible repercussions on the debtor); *In re Hal Luftig Co., Inc.*, No. 22-01176, 2023 Bankr. LEXIS 19, at *1 (Bankr. S.D.N.Y. 2023) (same).

¹¹ *See e.g.*, *In re Philadelphia Newspapers, LLC*, 407 B.R. 606 (E.D. Pa. 2009).

¹² *Id.* at 616.

¹³ *Id.* at 615–16.

¹⁴ *In re LTL Mgmt.*, 638 B.R. 291, 305 (Bankr. D.N.J. 2022), petition *dismissed*, 58 F.4th 738 (3d Cir. 2023) (dismissing bankruptcy filing for bad faith).

¹⁵ *Id.* at 306.

The mere fact of having an indemnification agreement is not dispositive.¹⁶ Although the court in *The Metal Center* extended the stay on equitable grounds, the court refused to extend the stay under section 362(a)(1), reasoning that a judgment in the suit against the third-party would not be binding on the bankruptcy court since the judgment would not necessarily be an allowed claim, nor was there a guarantee that the allowed claim would be in the same amount as the judgment rendered.¹⁷ Such uncertainty, the court reasoned, could potentially render the indemnification null, and the court found this sufficient to deny extension of the stay to the non-debtor despite the existence of an indemnification agreement.¹⁸

B. Similarity of Claims Against the Debtor and a Non-Debtor is not Sufficient to Create an Identity of Interests Warranting an Extension of the Automatic Stay to a Non-Debtor.

Similarity of claims against a debtor and non-debtor is not a type of ‘identity interest’ sufficient to extend the protections of the automatic stay to a non-debtor.¹⁹ To extend the stay to non-debtors, “there must be both ‘unusual circumstances’ and ‘something more than the mere fact that one of the parties has filed [for bankruptcy]’”²⁰ Further, there must be “*actual*, as opposed to an alleged or potential, identity of interests, such that a judgment against the non-bankrupt party would in fact be a judgment against the bankrupt party.”²¹ The *Divine Pipe* court, in declining to extend the stay, reasoned that *possible* respondeat superior liability faced by the

¹⁶ See e.g., *In re The Metal Center*, 31 B.R. 458, 463 (Bankr. D. Conn. 1983).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ See *Arnold v. Garlock*, 278 F.3d 426, 436 (5th Cir. 2001) (declining to extend the stay to non-bankrupt co-defendant facing the same allegations as bankrupt co-defendant because there was no formal tie or contractual indemnification obligation to create an identity of interests).

²⁰ *In re Divine Pipe, LLC*, 538 B.R. 300, 308 (Bankr. S.D. Tex. 2015) (quoting *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 999 (4th Cir. 1986)).

²¹ *Id.* at 312 (emphasis added).

debtor was insufficient to create an identity of interests under the *A.H. Robins Co.* test, as adopted by the Fifth Circuit.²²

II. The Automatic Stay has Been Extended to a Non-Debtor Where Pending Litigation, Though not Brought Against the Debtor, Would Cause the Debtor Irreparable Harm.

A. There is Irreparable Harm when the Action Against the Non-Debtor will Have an Immediate Adverse Economic Consequence for the Debtor's Estate.

i. An Immediate Adverse Economic Consequence can be Found Where Allowing Litigation to Proceed Against a Non-Debtor Threatens the Debtor's Reorganization Efforts.

The automatic stay can be extended to non-debtors when the continued prosecution of a claim against the non-debtor will have an “immediate adverse economic consequence for the debtor’s estate.”²³ Adverse economic consequences for the debtor can exist where a claim against a non-debtor threatens a debtor’s reorganization.²⁴ In *Hal Luftig Company, Inc.*, the bankruptcy court extended the corporate debtor’s stay to its sole shareholder, Mr. Luftig, who was jointly and severally liable with the corporate debtor on a judgment.²⁵ The bankruptcy court found it relevant that Mr. Luftig, as president and sole shareholder, was one of three employees of the debtor, and that the debtor was dependent on Mr. Luftig’s promotional efforts and investments to generate revenue.²⁶ Thus, if the judgment creditor was permitted to enforce its judgment against Mr. Luftig during the bankruptcy, Mr. Luftig would have to reduce his efforts for the debtor, threatening its ability to repay its creditors and jeopardizing any reorganization

²² *Id.*

²³ *Queenie, Ltd. v. Nygard Int'l*, 321 F.3d 282, 287–88 (2d Cir. 2003).

²⁴ *See In re Hal Luftig Co.*, No. 22-01176, 2023 Bankr. LEXIS 19, at *1 (Bankr. S.D.N.Y. Jan. 5, 2023).

²⁵ *Id.* at *10.

²⁶ *Id.* at *9.

efforts.²⁷ The bankruptcy court, in accord with the Fourth Circuit, recognized that this was an “unusual circumstance” warranting the extension of the stay to the non-debtor.²⁸

Similarly, the bankruptcy court in *In re Union Trust Philadelphia, LLC* found that the non-debtors played such a vital role in the debtor’s reorganization efforts, which included a personal guarantee to a loan commitment on behalf of the debtor and other financial assurances like the payment of taxes, that the debtor’s “ability to reorganize [was] clearly diminished and the [] estate risk[ed] substantial harm if it [was] deprived of the [non-debtors’] assistance in the reorganiz[ation].”²⁹

Despite some courts’ application of the Fourth Circuit’s extension of the automatic stay to non-debtors, other courts have refused to adopt the exceptions absent further guidance.³⁰ In *In re Aearo Techs.*, the debtor, Aearo, moved the bankruptcy court to stay pending litigation against its non-debtor affiliate, 3M. Relying on section 362(a)(1), Aearo argued that joint and several liability claims asserted in pending actions against the debtor Aearo and non-debtor 3M blurred the distinction between the two entities, rendering a potential judgment against non-debtor 3M to be in effect a judgment against Aearo, affecting the debtor’s property of the estate.³¹ The bankruptcy court recognized the exceptions to the general rule that the automatic stay does not extend to non-debtors but refused to apply them absent further guidance from the Seventh Circuit and uncertainty surrounding its application.³² The bankruptcy court also rejected Aearo’s request

²⁷ *Id.*

²⁸ *See id.* at *8, *10.

²⁹ *In re Union Trust Phila., LLC*, 460 B.R. 644, 658 (E.D. Pa. 2011) (citation omitted).

³⁰ *See In re Aearo Techs., LLC*, 642 B.R. 891, 904 (Bankr. S.D. Ind. 2022).

³¹ *Id.* at 900, 903–04.

³² *Id.* at 904–05 (“[The Seventh] Circuit has not, to date, expansively discussed or formally adopted *A.H. Robins* in this regard Nor has the Circuit actually extended the stay to a non-debtor party under that reasoning.”) (internal citations omitted).

for relief under sections 363(a)(3) and 105(a).³³ Aearo and 3M filed a direct appeal to the Circuit Court which is currently pending.³⁴

III. Extending the Automatic Stay Should not be Confused with Injunctive Relief Under Section 105(a) of the Bankruptcy Code.

Extending the automatic stay is not the same as providing injunctive relief under the court's equitable powers under section 105 of the Bankruptcy Code. Pursuant to section 105(a), "the court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the [Bankruptcy Code]."³⁵ Parties have relied on this section along with section 362(a) when requesting that the stay be extended to non-debtors.³⁶ In doing so, courts have often confused these distinct issues and use the phrases "extension of the stay" and "injunctive relief" interchangeably.³⁷ This has caused confusion among courts; specifically, "it is unclear whether the Third Circuit views staying an action to aid a debtor's reorganization the result of extending the section 362(a) stay or the result of issuing a separate injunction pursuant to, for example, a district court's inherent power to stay a pending action or a bankruptcy court's power under § 105(a)."³⁸ The Third Circuit in *LTL* has tried to clarify its stance, taking the position that section 362 serves as an independent basis for extending the stay, but the issue remains unsettled.³⁹

³³ *Id.* at 906–07, 910.

³⁴ Notice of Appeal, *In re Aearo Techs., LLC*, No. 1:22-ap-50059 (Bankr. S.D. Ind. Aug. 29, 2022), EFC No. 145.

³⁵ 11 U.S.C. § 105(a) (2018).

³⁶ *See e.g.*, *In re Aearo Techs., LLC*, 642 B.R. 891 (Bankr. S.D. Ind. 2022); *Edelson PC v. Girardi*, 2021 WL 3033616, at *1 (N.D. Ill. July 19, 2021).

³⁷ *See e.g.*, *A.H. Robins Co. v. Piccinin*, 788 F.2d 994 (4th Cir. 1986) (using "stay" and "injunction" interchangeably).

³⁸ *Stanford v. Foamex L.P.*, No. 07-4225, 2009 WL 1033607, at *1 n. 7 (E.D. Pa. Apr. 15, 2009).

³⁹ *In re LTL Mgmt.*, 638 B.R. 291, 301 (Bankr. D.N.J. 2022) (citing *McCartney v. Integra Nat. Bank. N.*, 106 F.3d 506 (3d Cir. 1997) (upholding extension of the stay to a non-debtor solely on the basis of section 362, and without mention of section 105(a) in its analysis)).

Other courts have labeled the distinction between the issues as purely academic warranting no further clarification or inquiry as the “practical effect (i.e., the staying of an action) is the same regardless of the means employed.”⁴⁰

But the distinction between an extension of the stay under section 362(a) and an injunction under section 105(a) is necessary because proceeding under section 105(a) requires a finding from the bankruptcy court that it has subject matter jurisdiction to issue such injunction.⁴¹

Conclusion

Courts have extended the automatic stay to non-debtors under section 362(a) when “unusual circumstances” exist.⁴² Such unusual circumstances exist where: (1) there is such identity between the debtor and third-party defendant that a judgment against the third-party defendant will in effect be a judgment against the debtor; and (2) where the pending litigation, though not brought against the debtor, would cause the debtor irreparable harm.⁴³ Bankruptcy courts, through a separate grant of equitable authority under section 105(a), may enjoin actions concerning non-debtors that threaten the debtor or the estate.⁴⁴ A court’s discussion of extending the automatic stay pursuant to section 362(a) or through injunctive relief shall carefully delineate its reasoning to avoid confusion and to properly formulate its analysis.⁴⁵

⁴⁰ *Foamex*, 2009 WL 1033607, at *1 n. 7; see also *In re Philadelphia Newspapers, LLC*, 423 B.R. 98, 103 n. 8 (E.D. Pa. 2010) (declining to “delve into this analytical quagmire . . . [regarding] . . . whether the order issued by the Bankruptcy Court constituted the extension of the stay under section 362(a) or an injunction under 105(a).”).

⁴¹ See *In re W.R. Grace & Co.*, 591 F.3d 164, 170–71 (3d Cir. 2009) (quoting *In re Combustion Eng’g Inc.*, 391 F.3d 190, 225 (3d Cir. 2004)).

⁴² See e.g., *A.H. Robins Co.*, 788 F.2d at 999.

⁴³ *Id.*

⁴⁴ See e.g., *Foamex*, 2009 WL 1033607, at *1.

⁴⁵ See *In re W.R. Grace & Co.*, 591 F.3d at 170–71.