

# Another Appellate Court Vacates A Bankruptcy Court Contempt Judgment

By Michael L. Cook

The Southern District of New York vacated a bankruptcy court's judgment holding a debtor's business competitor (C) "in contempt for violation of the [Bankruptcy Code's] automatic stay...and assessing sanctions" of \$19.2 million. *In re Windstream Holdings, Inc.*, 2022 WL 5245633, \*1 (2) (S.D.N.Y. Oct 6, 2022). The bankruptcy court had erroneously sanctioned C for a "literally false and intentionally misleading advertising campaign" to lure subscribers away from the debtor, mistakenly reasoning that C's advertisements violated the automatic stay by suggesting the debtor was going out of business. *Id.* According to the district court, though, C's "advertisements did not violate the...stay, and, in any case, there was a fair ground of doubt whether they did so." *Id.* at \*3.

## RELEVANCE

Appellate courts have not been afraid to overturn bankruptcy court sanctions. *In re Gravel*, 6 F. 4th 503, 508, 512-13 (2d Cir. 2021) (2-1) (bankruptcy court's punitive sanctions order vacated and reversed; "... a contempt order is warranted only

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where the party has notice of the order, the order is clear and unambiguous, and the proof of noncompliance is clear and convincing"; "... a bankruptcy court cannot hold a party in contempt for violating an order that is subject to varying interpretations.") *cert denied*. \_\_ U.S. \_\_ (June 13, 2022); *Beckhart v. Newrez LLC*, 31 F.4th 274, 275, 278 (4th Cir. 2022) ("neither the bankruptcy court nor the district court applied" the current standard for holding "a creditor in civil contempt" for violating a "confusing" Chapter 11 confirmation order; "any sanction that may ultimately be imposed must be supported – both in type and in amount – by a sufficient evidentiary record."); *In re DeGennaro, III*, 2020 WL 7231945,\*9 (S.D.N.Y. Dec. 8, 2020) (bankruptcy court sanctions vacated because of an abuse of discretion; order not "clear and unambiguous"; no "clear and convincing evidence of non-compliance" with order "whose terms cannot now be created"; no willful compliance with unclear order; no advance warning of possible contempt sanction; sanctions imposed ... too "quickly and without sufficient explanation."). Bankruptcy courts may still sanction parties, but their "contempt power... is narrowly circumscribed." *Gravel*, 6 F. 4th at 511, quoting *Perez v. Danbury Hosp.*, 347 F.3d 419, 423 (2d Cir. 2003).

## THE FACTS

The debtor and C "compete[d] ... in providing residential and commercial voice and data communication services ...." *Windstream*, 2022 WL 5245633, at \*1. After the debtor sought Chapter 11 relief in March, 2019, C "launched a direct-mail campaign directed at [the debtor's] customers," noting the bankruptcy, "uncertainty," and offering to "buy-out" the debtor's customers from their contracts with the debtor. According to the bankruptcy court when granting the debtor's motion for summary judgment, C "was liable for violating the automatic stay through its advertising campaign, ... an act to control property of the estate, namely, the debtor's customers or contracts with those customers." *Id.* at \*2, relying on Bankruptcy Code (Code) §362(a)(3) (staying acts to "obtain" or "exercise control" over estate property). The bankruptcy court later held a trial on contempt and sanctions; held C "in contempt"; and "sanctioned [C] \$19,179,329.45 for [the debtor's] losses ...." *Id.* at \*3.

## DISTRICT COURT ANALYSIS

*No Contractual Harm*. C conceded that Code §362(a)(3) "protects a debtor's executory contracts which are property of the debtor's estate under [Code] §541." *Id.* at \*4. It argued that the record contained "no evidence," however, "of any contracts" the debtor "had

with customers.” “[D]espite the lack of evidence regarding specifics of the contracts,” said the district court, the bankruptcy court “did not clearly err in concluding that [the debtor] had some kind of contracts” with its customers. *Id.* at \*6. In fact, C had asserted that: a) the debtor had “a two-year contract” with its customers; and b) it bought out 32 such customer contracts. *Id.* But the district court declined to address the contract issue because C’s “advertisements were not acts to ‘obtain’ or ‘control’ any such contracts.” *Id.*

**No Impairment of Debtor’s Goodwill.** The district court further rejected the bankruptcy court’s finding that C’s advertising “affected” the debtor’s “goodwill in the marketplace.” *Id.* C never “misuse[d]” the debtor’s “intellectual property ... or proprietary business information (like customer lists or trade secrets) ....” *Id.* C’s “forward looking representations about [the debtor’s] business prospects” did not impair “any goodwill that is cognizable as a property interest.” *Id.*

**No Control Over Debtor’s Property.** C’s advertisements were not “an act to obtain possession of property of the estate or to exercise control over property of the estate,” as Code §362(a) (3) provides. According to the district court, “solicitation of a debtor’s customers” is “not typically regard[ed] as ‘exercising control’ over property.” *Id.* at \*7. Rejecting the bankruptcy court’s reasoning, the district court said that “nothing in the ‘plain terms’ of §362(a) (3) ... suggests that improper advertisements are methods of ‘control’ ....” *Id.* The automatic stay, it reasoned, “does not prohibit all conduct that harms or interferes with a debtor’s business, but only that which amounts to an effort to obtain or control estate property.” *Id.* Nor does the stay enjoin “any attempt to compete with an entity going through reorganization ..., whether wrongful or not.” *Id.* C’s advertising

“sought to influence customer choice,” but was not “an act to ‘exercise control’ over contracts or goodwill.” *Id.* at \*8. Accurate advertising may be manipulative, but “in any case, the customer is not property of the estate.”

**No Strict Liability for Civil Contempt.** “Even if [C’s] conduct violated the automatic stay,” held the district court, “the Bankruptcy Court abused its discretion in concluding that there was no fair ground of doubt as to whether the advertisements were a violation of the automatic stay.” *Id.* at \*9. Relying on the Supreme Court’s holding in *Taggart v. Lorenzen*, 139 S. Ct., 1795, 1799, 1801 (2019) (civil contempt “authorized” “when there is ‘no fair ground of doubt’ as to whether the order barred the creditor’s conduct.”) (emphasis in original), the district court explained that the contempt power for a corporate debtor such as the debtor here is based on Code §105(a), but not §362(k)(1) which is only available to “individual” debtors (natural persons). *Id.* at \*9, citing *In re Chateaugay Corp.*, 920 F.2d 183, 186-87 (2d Cir. 1990). Unlike 362(k), which imposes “strict liability” for stay violations against an individual debtor, the district court here applied the “more searching standard” of *Taggart* to a §105(a) contempt action against a corporate debtor. *Id.* at \*11-\*12. Accordingly, the bankruptcy court erred in finding “no fair ground of doubt” that C’s advertisements were a stay violation. Whether C’s advertisements “‘exercised[d] control’ over estate property is at least highly debatable. The plain language of the ... stay does not clearly proscribe the conduct here, as advertising (even misleading advertising) is not typically understood to exercise control over property.” *Id.* at \*11.

## COMMENT

The *Windstream* decision is based on fairness. As the Supreme Court stressed in *Taggart*: “civil contempt is

a severe remedy” and “basic fairness requires that those enjoined receive explicit notice of what conduct is outlawed.” 139 S. Ct. at 1802.

The *Windstream* court also rejected the bankruptcy court’s argument that C should have “sought clarification from the court or be sanctioned for shooting first and aiming later.” 2022 WL 5245633, at \*10-\*11. According to the district court, “it is contrary to *Taggart* to read into [Code] §105(a) a requirement that a creditor seek clarification from the court or be sanctioned ... if the creditor is unsure whether its contemplated course of conduct would run afoul of the automatic stay ... [T]he Court is bound to follow the Supreme Court’s interpretation of [§105(a)], under which there is no requirement that the would-be violator move to lift the stay prior to acting.” *Id.* at \*11, citing *Taggart*, at 1803 (“We doubt ... that advance determinations would provide a workable solution to a creditor’s potential dilemma,” but would “instead risk additional federal litigation, additional costs, and additional delays,” and would impair “a prompt and effectual resolution of bankruptcy cases within a limited period.”).

