UNITED STATES BANKRUPTCY COURT
Eastern District of California
501 I Street, Suite 3-200
Sacramento CA, 95814-7303

Chambers of
FREDRICK E. CLEMENT **916-930-4540**
Chief Bankruptcy Judge

October 25, 2022

re: Corporate Ownership Statements in cases and Adversary Proceedings
Federal Rules of Bankruptcy Procedure 1007(a)(1), 7007.1

An Open Letter to the Bar:

Recently, the Ninth Circuit Court of Appeals has reminded all courts within its jurisdiction of the importance of screening incoming and existing cases, including adversary proceedings, for financial conflicts of interest. One financial conflict of interest that is particularly problematic and, which is often difficult to spot at the outset, is assessing where a corporation stands in a corporate parent relationship to the debtor or a party to an adversary proceeding.

No doubt you know, a judge may not preside over a dispute involving a corporation in which the judge or certain close family members own stock. Canon 3(C)(1)(c), Code of Conduct for United States Judges. But you may be unaware that the judge's disqualification, by reason of stock ownership, extends to parent companies of parties, provided the parent company owns at least 10% of the debtor or a party to the adversary proceeding. An example may help in clarifying the problem. If a plaintiff files an adversary proceeding against defendant subsidiary corporation and if a non-party parent corporation owns at least 10% of defendant subsidiary corporation's stock, a federal judge owning stock in *either* defendant subsidiary corporation or in the non-party parent corporation would be disqualified from hearing the dispute. The rub is that it is sometimes difficult to know whether the debtor or party to an adversary proceeding stands in a parent-subsidiary corporate relationship.

Adopted in 2003, Rules 1007(a)(1) and 7007.1 require parties to disclose the existence of corporate parent-subsidiary relationships at the outset of the case, thereby, allowing the court to determine at the commencement of a proceeding whether the assigned judge has a disqualifying conflict of interest. These rules require corporate debtors in parent cases, as well as corporate plaintiffs and defendants in adversary proceedings, to file a Corporate Ownership Statement at the time of their first appearance that informs the court whether: (1) the debtor/plaintiff/defendant has a parent corporation; and (2) the identification of any publicly traded corporation that owns 10% or more of the debtor/plaintiff/defendant's stock. Unfortunately, these rules have been largely honored in the breach.

These rules have four parts. First, since these rules only apply to corporations, it is important that petitions, adversary complaints, as well as responsive pleadings and Rule 12 motions, make the corporate status of the debtor and/or parties clear. For example, if a defendant to an adversary proceeding files an answer as "Wayne's Garage," it is unclear whether the party is an improperly named individual, i.e., 'Wayne Blackwelder doing business as Wayne's Garage"; a partnership; or a corporate entity, e.g., "Wayne's Garage, Inc."

Second, Rules 1007(a) and 7007.1 require that all "nongovernmental corporation[s]" that file a petition or are parties to an adversary proceeding file a corporate ownership statement indicating the existence of a corporate parent. Excepting only governmental corporations, as used in those rules, "corporation" includes all entity parties, corporations, and limited liability companies.

Third, the corporate ownership statement must identify any publicly held corporation that owns 10% or more of the debtor/party or state that no such corporate parent exists. Phrased in the reverse, parties are not excused from filing the corporate ownership statement because no parent corporation exists or because the parent corporation owns less than 10% of the party's stock. Even though Rules 1007(a)(1) and 7007.1 only require a debtor or party to disclose the percentage of stock in the debtor owned by publicly held corporations, Rule 3C(1)(c) (disqualifying financial conflicts) of the Code of Conduct for United States Judges applies with equal force to privately held corporate parents. When in doubt, err on the side of over disclosure.

To assist the parties in complying with Rules 1007(a)(1) and 7007.1, the Clerk of the Court has promulgated EDC Form 3-500 ("Statement Regarding Ownership of Corporate Debtor/Party"). That form is the preferred means of disclosure in the Bankruptcy Court for the Eastern District of California and is available on the court's website.

Fourth, this disclosure must be filed with the corporate party's first appearance, e.g., complaint, answer, motion to dismiss, stipulations to enlarge time to answer. That disclosure must be supplemented "whenever the information required by [Rule 7007.1] changes."

As we move forward, you will notice an increased push from the Clerk of the Court and from the collective bench to require the filing of the "Corporate Ownership Statement" in both parent cases and adversary proceedings. Please help us by making clear the status of debtors and parties and by making timely, as well as complete, disclosures of corporate ownership in cases and adversary proceedings.

Sincerely,

Fredrick E. Clement