

## THE SUPREME COURT HAS HELD THE U.S. BANKRUPTCY CODE WAIVES TRIBAL SOVEREIGN IMMUNITY — WHAT THIS MEANS FOR TRIBES AND TRIBAL BUSINESS ENTERPRISES

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Last week in *Lac du Flambeau Band of Lake Superior Chippewa Indians v. Coughlin*, the United States Supreme Court held that the U.S. Bankruptcy Code includes a waiver of tribal sovereign immunity. By an 8-1 vote, the Court held that Indian tribes are “governmental units” as defined in 11 U.S.C. § 101(27), which means that immunity is waived under 11 U.S.C. § 106(a) for certain bankruptcy-specific claims. Neither the statutory definition of “governmental unit,” nor § 106(a)’s sovereign immunity waiver, expressly mentions Indian tribes, but the Court determined that the catch-all phrase “other foreign or domestic government” was clear enough.

In his lone dissent, Justice Neil Gorsuch noted that the decision was the first time the Supreme Court had found that Congress intended to abrogate tribal sovereign immunity without expressly mentioning Indian tribes in the statute. He further explained that “[p]roperly understood, Indian Tribes occupy a unique status that is neither politically foreign nor domestic.” The majority, however, found that the sovereign immunity waiver applies, and tribes should be aware of the ruling’s effects.

The waiver recognized in *Coughlin* is limited to certain bankruptcy specific claims and does not change the status quo in other areas of bankruptcy law or in non-bankruptcy contexts. The decision, however, represents a major development in the law applicable to tribes and tribal enterprises as creditors in bankruptcy proceedings.

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### ***Tribes and Tribal Business Enterprises as Creditors are Subject to Certain Bankruptcy Specific Claims***

The *Coughlin* decision will affect tribes and tribal business enterprises most directly as creditors to a debtor in bankruptcy. Section 106(a) identifies dozens of specific provisions of the Bankruptcy Code to which the immunity waiver applies. Among the identified provisions, the most commonly invoked are those related to violations of the automatic stay (11 U.S.C. § 362), and avoidance actions to recover preferential payments (11 U.S.C. § 547) or fraudulent transfers (11 U.S.C. § 548).

The *Coughlin* case itself arose as a claim by a bankruptcy trustee against a tribally owned lender for alleged violations of the automatic stay, which precludes a creditor from communicating with a debtor or otherwise attempting to collect a debt once a bankruptcy petition has been filed. Preference actions involve a bankruptcy trustee seeking to recover payments made by the debtor to a creditor within the months prior to filing for bankruptcy while the debtor was insolvent. Fraudulent transfer claims are to recover property that a debtor conveyed in the months prior to filing for bankruptcy while insolvent. Prior to *Coughlin*, a split of authority existed in which several courts had held that tribal sovereign immunity barred these types of claims, while other courts held that § 106(a) waived immunity. In *Coughlin*, the Supreme Court resolved the split by holding that § 106(a) waived immunity for Indian tribes. Thus, tribes and tribal business enterprises who are creditors should be aware that claims can be asserted against them in a bankruptcy court.

Importantly, however, the sovereign immunity waiver does not extend to any other claim not specifically defined in § 106(a). Thus, while bankruptcy courts have limited jurisdiction to resolve disputes over debts or claims that had not been determined prior to the bankruptcy filing, tribes maintain immunity for any such claim except for those specifically created by the Bankruptcy Code and identified in § 106(a).

### ***Tribe and Tribal Business Enterprises Are Still Likely Ineligible to File for Bankruptcy Protection***

Whether an Indian tribe or tribal business enterprise can file for bankruptcy protection is—and remains—an open question. There are only a handful of examples in which a tribal business enterprise has attempted to file a bankruptcy petition. The two most prominent examples resulted in a dismissal without a written opinion and a settlement prior to judicial determination on eligibility. Although not the subject of the *Coughlin* decision, its reasoning almost certainly means that bankruptcy is not an option for tribes or tribal business enterprises.

Under 11 U.S.C. § 109, which defines eligibility for bankruptcy protection, only “persons” or “municipalities” are eligible. Tribes are not “municipalities” because that term requires political existence under state law. The definition of “person” includes “corporations” and other entities, but expressly excludes “governmental units,” which Indian tribes now clearly are after *Coughlin*. Previously, some tribally owned business enterprises had argued that they are separate from the tribal government and should be defined as “corporations” for purposes of the Bankruptcy Code’s definition of “person.” That argument was already somewhat of a stretch under existing precedent, including a long line of Supreme Court cases holding that tribal business enterprises enjoy

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tribal sovereign immunity, even for off-reservation economic activity. While the tribe was the party in the *Coughlin* case, the bankruptcy claim was technically asserted against a tribally owned lending enterprise.

Thus, so long as tribal business enterprises exist as “arms of the tribe” for purposes of tribal sovereign immunity, they likely are “governmental units” for purposes of the Bankruptcy Code. Unless and until a court rules otherwise, it appears that the status quo remains that neither Indian tribes nor their wholly-owned tribal business enterprises are eligible to seek bankruptcy protection.

### ***Tribes and Tribal Business Enterprises Cannot be Forced Into Involuntary Bankruptcy***

Under 11 U.S.C. § 303, three or more creditors can force a financially distressed debtor into involuntary bankruptcy. The purpose is to protect assets an insolvent debtor has on hand before financial struggles worsen and forcing a distribution. The ability of creditors to force a tribal government or business enterprise would be of significant concern, and would change the dynamic that most tribes, lenders, and vendors have come to expect when drafting contracts with provisions specific to business in Indian country or workout agreements during times of financial distress. However, like eligibility for voluntary bankruptcy, this provision of the code applies only to “persons” which expressly excludes “governmental units.” Thus, after *Coughlin*, tribes and their business enterprises cannot be forced into involuntary bankruptcy.

The potential exists that a group of creditors could attempt to distinguish tribal business enterprises from the realm of “governmental units,” but as noted above, it is unlikely to succeed, especially after *Coughlin*, which originated as a claim against a tribal lending enterprise. With respect to both voluntary and involuntary bankruptcy, it appears that the status quo has not changed, and if anything, is stronger than before with the likelihood that tribes and tribal business enterprises are ineligible.

### ***Taxes Owed to Tribes are Given Priority and Are Excluded from Bankruptcy Discharge***

The status of tribes as “governmental units” comes with some notable benefits. While the *Coughlin* decision turned on the sovereign immunity waiver of § 106(a), its underlying premise was the definition of a “governmental unit” under § 101(27). The latter provision affects several other provisions of the code in which “governmental units” are addressed.

The above example of the inability of creditors to force a tribal business enterprise into involuntary bankruptcy is based on that section’s express exclusion of “governmental units,” and is arguably a benefit not enjoyed by other private sector business enterprises. At least two other provisions in which “governmental units” benefit under the Bankruptcy Code concern priorities in distributions from a bankruptcy estate and exclusions from discharge. Under 11 U.S.C. § 507(8), certain taxes and penalties owed to a “governmental unit” are given priority during distribution. Accordingly, such debts are usually paid before unsecured claims, and the possibility of recovery in full is greatly increased. Another benefit is found at 11 U.S.C. § 523, which excludes from a debtor’s

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discharge certain taxes, fines, penalties, and forfeitures owed to a “governmental unit.”

Thus, to the extent a debtor in bankruptcy might owe these types of debts to a tribe, the right to collect is undisturbed by a bankruptcy discharge absent exceptional circumstances.

The opinion was issued in *Lac du Flambeau Band of Lake Superior Chippewa Indians et al. v. Brian W. Coughlin*, No. 22-227 (S. Ct.).

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