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# Adversary Proceeding Complaint to Subordinate a Claim

The following is an excerpt of a Standard Document from our website for an adversary proceeding complaint to subordinate a claim under section 510(b) or (c) of the Bankruptcy Code. This resource includes integrated notes with important explanations and drafting tips. For the complete, continuously maintained version of this resource, visit Practical Law.

## *Practical Law Bankruptcy*

**A** Chapter 11 debtor or Chapter 11 trustee seeking to subordinate claims to a lower priority should file a complaint initiating an adversary proceeding. Generally, the complaint alleges that the claim arose from either:

- The purchase or sale of a security of the debtor, and should be mandatorily subordinated under section 510(b) of the Bankruptcy Code (for more information, search [Mandatory Subordination in Bankruptcy](#) on Practical Law).
- The misconduct of the holder of the claim, and should be equitably subordinated under section 510(c) of the Bankruptcy Code (for more information, search [Lenders Beware: The Risk of Equitable Subordination in Bankruptcy](#) on Practical Law).

An adversary proceeding complaint must be accompanied by an Adversary Proceeding Cover Sheet (Procedural Bankruptcy Form B1040, available at [uscourts.gov](http://uscourts.gov)).

Before filing an adversary proceeding complaint or any other document with the bankruptcy court, plaintiff's counsel should review the relevant sections of:

- The Federal Rules of Bankruptcy Procedure (Bankruptcy Rules). In particular, counsel should refer to:
  - Part VII, which governs adversary proceedings and contains rules that adopt the corresponding provisions in the Federal Rules of Civil Procedure (FRCP); and
  - Part IX, which includes general procedural rules that apply in all bankruptcy proceedings, including adversary proceedings and contested matters.

- The FRCP.
- The bankruptcy court’s local rules.
- The bankruptcy court’s standing orders.
- The case management/electronic case filing (CM/ECF) rules for the court.
- Any provisions of a case management order regarding adversary proceedings in the bankruptcy case.
- The individual practice rules for the judge presiding over the bankruptcy case.

Additionally, counsel should note that courts generally permit the creditors’ committee to seek leave to bring an adversary

proceeding on behalf of the debtor’s estate (see *Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 330 F.3d 548, 564-66 (3d Cir. 2003)) (for more information, search [Chapter 11 Creditors’ Committees](#) on Practical Law). To determine if these entities have standing in the relevant jurisdiction, counsel should review the local case law, local rules, and standing orders for the district where the proceeding is brought.



Search [Commencing an Adversary Proceeding](#) for more on drafting an adversary proceeding complaint and preparing other case-initiating documents in accordance with the FRCP and the Bankruptcy Rules.

Search [Commencing a Federal Lawsuit: Drafting the Complaint](#) for more on drafting a complaint in accordance with the FRCP.

### COMPLAINT AND SELECTED DRAFTING NOTES

[[LAW FIRM NAME]  
 [LAW FIRM ADDRESS]  
 [LAW FIRM TELEPHONE NUMBER]  
 [ATTORNEY NAME]  
 [ATTORNEY EMAIL ADDRESS]]

**[Counsel to [CLIENT STATUS]]**

#### IN THE UNITED STATES BANKRUPTCY COURT FOR THE [DISTRICT] DISTRICT OF [STATE]

-----X  
 In re : Chapter [7/11/13]  
 [CASE NAME], : Case No. [NUMBER] [JUDGE’S INITIALS]  
 Debtor[s]. : [Jointly Administered]  
 -----X  
 [NAME[S]], :  
 Plaintiff[s] :  
 v. :  
 [NAME[S]], : Adv. Pro. No. [NUMBER] [JUDGE’S INITIALS]  
 Defendant[s]. :  
 -----X

#### COMPLAINT TO SUBORDINATE CLAIM OF [CREDITOR] UNDER SECTION [510(b)/510(c)] OF THE BANKRUPTCY CODE

Plaintiff[s], [[DEBTOR[S]], debtor[s] and debtor[s]-in-possession (“**Debtor[s]**”)/the Chapter 11 trustee (“**Trustee**”)/the Official Committee of Unsecured Creditors (“**Committee**”), in the above-captioned bankruptcy case[s] and as plaintiff[s] in the above-captioned adversary proceeding hereby allege[s], upon [its/their] own knowledge or upon information and belief, as follows:

#### PRELIMINARY STATEMENT

1. This is an adversary proceeding seeking to [mandatorily/equitably] subordinate the claim[s] (“**Claim[s]**”) of [DEFENDANT[S]] (“**Defendant[s]**”), pursuant to section [510(b)/510(c)] of the Bankruptcy Code.

2. The Claim[s] arise[s] from [the purchase or sale of the [common stock/[OTHER SECURITY]] of the Debtor[s]/[a debt/debts] owed to the Defendant[s] by the Debtor[s]].

## DRAFTING NOTE

### PRELIMINARY STATEMENT

The preliminary statement generally describes the case by identifying:

- The main parties.
- The key facts.
- The legal causes of action.
- The relief sought.

### JURISDICTION AND VENUE

3. This Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. §§ 157 and 1334 and Plaintiff[s] [consent[s]/do[es] not consent] to entry of a final order or judgment by the Bankruptcy Court in this matter.

4. Venue is proper in this district under 28 U.S.C. § 1409(a). This adversary proceeding is related to a bankruptcy case under Chapter [7/11/13] that is pending in this district (Case No. [NUMBER]).

5. This adversary proceeding is commenced pursuant to Bankruptcy Rule 7001(8), and section [510(b)/510(c)] of the Bankruptcy Code.

## DRAFTING NOTE

### JURISDICTION AND VENUE

The plaintiff's complaint must include:

- A short and plain statement of the grounds for the court's subject matter jurisdiction over the case (Fed. R. Bankr. P. 7008; FRCP 8(a)(1)).
- A statement that the plaintiff does or does not consent to entry of a final judgment or order by the bankruptcy court (Fed. R. Bankr. P. 7008).
- A statement indicating why venue is proper in the chosen court.
- A reference to the name, number, and chapter of the related bankruptcy case and court in which the bankruptcy case is pending.
- A reference to the relevant subsections of Bankruptcy Rule 7001 and section 510 of the Bankruptcy Code under which the adversary proceeding is being brought.



Search [Bankruptcy Basics: What Commercial Litigators Need to Know](#) for more on bankruptcy court jurisdiction.

The proper venue for an adversary proceeding is the district in which the related bankruptcy case is pending (28 U.S.C. § 1409(a)). However, this rule is subject to limited exceptions. Specifically, actions:

- By the debtor or a trustee to recover money judgments in amounts not exceeding the limits set by statute must be filed in the district where the defendant resides (28 U.S.C. § 1409(b)).
- By a trustee under section 541 or 544(b) of the Bankruptcy Code must be filed in the district as determined under nonbankruptcy law (28 U.S.C. § 1409(c)).
- By or against a trustee based on postpetition operations of the debtor's business must be filed in the district as determined under nonbankruptcy law (28 U.S.C. § 1409(d), (e)).

The district court in which a proceeding is pending may transfer venue to another district in the interest of justice or for the convenience of the parties (28 U.S.C. § 1412).



Search [Venue in Bankruptcy Proceedings](#) for more on the proper venue for an adversary proceeding.

## PARTIES

6. Plaintiff[s] [is/are] [the Debtor[s]/Trustee/Committee/a creditor] in the above bankruptcy case. [The Committee is authorized to bring this action pursuant to an order entered on [DATE].]

7. [DEFENDANT] is [[a corporation/partnership/[OTHER ENTITY]] having a principal place of business at [ADDRESS]/an individual residing at [ADDRESS]].

8. [ADDITIONAL SEPARATE PARAGRAPHS AS NEEDED FOR EACH DEFENDANT.]

### DRAFTING NOTE

#### PARTIES

This section should identify each plaintiff and defendant, state their addresses, and include facts explaining why they are parties to the lawsuit.



Search [Adversary Proceeding Complaint to Subordinate a Claim](#) for information on when a party may proceed against a defendant using a fictitious name.

## FACTUAL BACKGROUND

9. On [PETITION DATE] (the “**Petition Date**”), the Debtor[s] filed [a] voluntary petition[s] for relief under Chapter [7/11/13] of the Bankruptcy Code. [The Debtor[s] continue[s] in possession of [its/their] property and manage[s] [its/their] business[es] as [a] debtor[s]-in-possession pursuant to sections 1107 and 1108 of the Bankruptcy Code/On [DATE], the Court approved the appointment of [NAME] as the Chapter 11 trustee.]

10. [Additional information regarding the Debtor[s] and [its/their] bankruptcy case, including the Debtor[’s/s’] business[es], financial condition, corporate structure, and the reasons and objectives for the case, are set forth in the [FIRST DAY AFFIDAVIT] filed in the Debtor[’s/s’] main bankruptcy case/[Nature of the Debtor[’s/s’] business[es] and operations and reason for filing the bankruptcy case]].

11. On [DATE], Defendant[s] filed [a] proof[s] of claim against the Debtor[s] in the amount of [AMOUNT OF CLAIM[S]]. Debtor has designated the Claim[s] as Claim No[s]. [NUMBER[S]].

12. The Claim[s] [is/are] for damages arising from [SPECIFIC FACTS GIVING RISE TO THE CLAIM[S]].

13. [Defendant[s] assert[s] that the Claim[s] [is/are] [TYPE OF CLAIM] having a priority higher than [general unsecured/other] claims asserted against the Debtor[s].

### OR

Defendant[s] [was/were] the [TITLE[S]] of the Debtor[s] when the Claim[s] arose. At that time, Defendant[s] abused [his/her/their] power and position by [CONDUCT OF DEFENDANT[S]] for [his/her/their] own benefit which placed [him/her/them] at an unfair advantage over other creditors.

### OR

Defendant[s] obtained the Claim[s] through abuse or misconduct.]

[14. Debtor[s] [has/have] refused to seek subordination of the Claim[s] under section 510[(b)/(c)] of the Bankruptcy Code.]

[15. On [DATE], at the request of the Committee, the Bankruptcy Court entered an order authorizing the Committee to bring this adversary proceeding.]

## DRAFTING NOTE

### FACTUAL BACKGROUND

The complaint should include only a short and plain statement of the claim showing that the plaintiff is entitled to relief (FRCP 8(a)(2)). This means the plaintiff must plead facts sufficient to give rise to a claim that is plausible on its face, but generally is not required to plead detailed factual allegations (see *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citing *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556-57, 570 (2007))).

In some cases, a plaintiff might need to plead its claims:

- **Based on information and belief.** A plaintiff that does not know all of the facts when it files the complaint may allege that certain facts are true based on information and belief. Most courts have held that a plaintiff may meet the plausibility standard articulated in *Iqbal* and *Twombly* when it pleads facts on information and belief, if either:

- the facts are peculiarly within the possession and control of the defendant; or
- the belief is based on facts that make the inference of culpability plausible.

(See *Arista Records LLC v. Doe 3*, 604 F.3d 110, 120 (2d Cir. 2010); but see *New Albany Tractor, Inc. v. Louisville Tractor, Inc.*, 650 F.3d 1046, 1051 (6th Cir. 2011) (holding that the pleading standard set out in *Twombly* and *Iqbal* required dismissal of the complaint even though the facts were solely within the control of the defendant).)

- **With particularity.** Although courts generally do not require detailed factual allegations in the complaint,

plaintiffs must plead some claims with particularity. For example, under FRCP 9, made applicable in adversary proceedings by Bankruptcy Rule 7009, allegations of fraud must describe the fraudulent conduct and not be speculative or conclusory.

Additionally, if there are multiple debtors each involved in its own bankruptcy case, the facts should state whether or not the bankruptcy cases are jointly administered for procedural purposes (Fed. R. Bankr. P. 1015) (for more information, search [First Day Motions: Overview](#) on Practical Law).

Other considerations for preparing the factual background section of the complaint include:

- **Formatting.** The complaint should state the relevant facts in numbered paragraphs, with each paragraph limited to a single set of circumstances, as far as practicable (Fed. R. Bankr. P. 7008, 7010; FRCP 8(a)(2), 10(b)). If the facts section is lengthy, counsel should organize the facts under headings and, if necessary, sub-headings.

- **Redaction.** The plaintiff must redact certain personal information from the complaint before filing it with the court (Fed. R. Bankr. P. 9037(a)) (for more information, search [Filing Documents in Federal District Court](#) on Practical Law).

- **Exhibits.** The plaintiff should attach documents that:

- support the causes of action in the complaint; and
- dispute the creditor's security interest, lien, or claim.

(See below *Drafting Note, Exhibits*.)

### COUNT ONE [(MANDATORY SUBORDINATION)]

16. Plaintiff[s] repeat[s] and reallege[s] paragraphs 1 through [IMMEDIATELY PRECEDING PARAGRAPH NUMBER] hereof, as if fully set forth herein.

17. Section 510(b) of the Bankruptcy Code requires that a claim arising from the purchase or sale or rescission of the purchase or sale of a security of a debtor or an affiliate of a debtor must be subordinated to all claims that are senior to or that equal the claims of current holders of that security. If the security is common stock, the holder of the claim has the same priority as current holders of common stock.

18. Defendant['s/s'] Claim[s] [arise[s] from rescission of/[is/are] for damages arising from] the [purchase/sale] of the [common stock/securities] of the [Debtor[s]/an affiliate of the Debtor[s]].

19. Defendant['s/s'] Claim[s] against the Debtor[s] [is/are] subject to mandatory subordination under section 510(b) of the Bankruptcy Code.

OR

#### (EQUITABLE SUBORDINATION)

16. Plaintiff[s] repeat[s] and reallege[s] paragraphs 1 through [IMMEDIATELY PRECEDING PARAGRAPH NUMBER] hereof, as if fully set forth herein.

17. Section 510(c) of the Bankruptcy Code provides that after notice and a hearing, the bankruptcy court may under the principles of equitable subordination either:

a. Subordinate for purposes of distribution all or part of an allowed claim or interest to all or part of another allowed claim or interest; or

b. Order that any lien securing such subordinated claim be transferred to the estate.

18. Defendant[s] engaged in inequitable conduct, which resulted in injury to creditors and/or conferred an unfair advantage on Defendant[s] as [a] creditor[s] in the Chapter 11 case.

19. Equitable subordination is consistent with the Bankruptcy Code.]

### DRAFTING NOTE

#### LEGAL CLAIMS

The complaint should list under separate headings each of the plaintiff's legal claims or causes of action, typically referred to as counts. Each paragraph under a particular count should address a different element of the cause of action, including any relevant statute or common law required to establish the claim or cause of action.

The plaintiff may assert as many claims as it has against the defendant, including claims in the alternative, inconsistent claims, and claims that are independent of one another (Fed. R. Bankr. P. 7008, 7018; FRCP 8(d)(2)-(3), 18(a)).

Although the plaintiff may incorporate by reference the facts section of the complaint into the legal claims section, a court may dismiss the complaint if the plaintiff fails to clearly state which facts support which claims against the defendant (see, for example, *Discon Inc. v. NYNEX Corp.*, 1992 WL 193683, at \*16 (W.D.N.Y. June 23, 1992)).

#### Mandatory Subordination

For mandatory subordination under section 510(b) of the Bankruptcy Code, the plaintiff must allege some nexus to a purchase or

sale of a security of the debtor or an affiliate of the debtor (see *Pensco Tr. Co. v. Tristar Esperanza Props., LLC* (*In re Tristar Esperanza Props., LLC*), 782 F.3d 492, 497 (9th Cir. 2015) (stating that the term "arising from" in section 510(b) is interpreted broadly and reaches even ordinary breach of contract claims as long as there is a sufficient nexus with the purchase of securities); *Baroda Hill Invs., Ltd. v. Telegroup, Inc.* (*In re Telegroup, Inc.*), 281 F.3d 133, 138, 144 (3d Cir. 2002) (finding claims for breach of a provision in a stock purchase agreement are subject to mandatory subordination); *Allen v. Geneva Steel Co.* (*In re Geneva Steel Co.*), 281 F.3d 1173, 1174, 1182-83 (10th Cir. 2002) (finding claims alleging fraud based on nondisclosures that caused a claimant to hold, rather than sell, his securities are subject to mandatory subordination)).



Search [Mandatory Subordination in Bankruptcy](#) for more on mandatory subordination.

#### Equitable Subordination

For equitable subordination under section 510(c) of the Bankruptcy Code, the plaintiff

must establish by a preponderance of the evidence that:

- The defendant engaged in inequitable conduct.
- The inequitable conduct:
  - caused injury to a creditor; and
  - conferred an unfair advantage to the defendant.
- Equitable subordination is consistent with the provisions of the Bankruptcy Code.

(See *United States v. Noland*, 517 U.S. 535, 538-39 (1996); *In re Lifschultz Fast Freight*, 132 F.3d 339, 344 (7th Cir. 1997); *Gecker v.*

*Flynn (In re Emerald Casino, Inc.)*, 530 B.R. 44, 206-07 (N.D. Ill. 2014).)

If the plaintiff fails to prove any one of these elements, the court may deny equitable subordination (see *SI Restructuring, Inc. v. Faulkner (In re SI Restructuring, Inc.)*, 532 F.3d 355, 361-64 (5th Cir. 2008) (denying equitable subordination because although the court found inequitable conduct, it found no injury to other creditors)).



Search [Lenders Beware: The Risk of Equitable Subordination in Bankruptcy](#) for more on equitable subordination.

**WHEREFORE**, Plaintiff[s] demand[s] judgment against Defendant[s]:

- A. [Subordinating the Claim[s] to the claims of all unsecured creditors and to the same priority of claims of holders of common stock pursuant to section 510(b) of the Bankruptcy Code/ Equitably subordinating the Claim[s] pursuant to section 510(c) of the Bankruptcy Code].
- B. For such other and further relief as the Court deems just and proper.

## DRAFTING NOTE

### REMEDIES

Plaintiff's counsel should research and request all available remedies for the plaintiff's claims against the defendant, such as compensatory damages, punitive damages, statutory damages, injunctive or other equitable relief, interest, costs, and attorneys' fees. Counsel should check the

court's local rules for any requirements on pleading damages in the complaint. For example, the US District Court for the Middle District of Pennsylvania prohibits parties from specifying a dollar amount for unliquidated damages in certain limited circumstances (see *Miller v. Zandieh*, 2015 WL 519051, at \*12 (M.D. Pa. Jan. 12, 2015) (applying M.D. Pa. L. Civ. R. 8.1)).

Dated: [DATE]  
[CITY, STATE]

Respectfully submitted,  
[LAW FIRM NAME]

-----  
[ATTORNEY NAME]  
[LAW FIRM ADDRESS]  
[LAW FIRM TELEPHONE NUMBER]  
[ATTORNEY EMAIL ADDRESS]  
Attorneys for [PLAINTIFF NAME[S]]

**[VERIFICATION/AFFIDAVIT]**

[I [declare/certify/verify/state] under penalty of perjury that the foregoing is true and correct.

Executed on: [DATE].

-----  
[PLAINTIFF NAME]

**OR**

I, [PLAINTIFF/DECLARANT], having been duly sworn, hereby declare that:

1. I am the [TITLE] of the Debtor[s].
2. I have read the attached Complaint.
3. I am fully familiar with the facts set forth therein and they are true and correct to the best of my information and belief.

-----  
[PLAINTIFF/DECLARANT NAME AND TITLE]

Sworn to me this \_\_\_ day of \_\_\_\_\_, 20\_\_.

-----  
[NOTARY PUBLIC]

**EXHIBIT [NUMBER/LETTER]****DRAFTING NOTE****EXHIBITS**

The plaintiff may attach to the complaint copies of “written instruments” that are essential to the determination of the action, which then become part of the complaint for all purposes (Fed. R. Bankr. P. 7010; FRCP 10(c)).

Examples of documents that a plaintiff may properly attach as exhibits to a complaint include relevant:

- Contracts.
- Underlying arbitration awards.
- Correspondence.

Examples of documents that typically should not be attached as exhibits to a complaint include:

- Affidavits. Depending on the jurisdiction, the court may not consider an affidavit

to constitute a written instrument that becomes part of the complaint under FRCP 10(c) (see, for example, *Smith v. Hogan*, 794 F.3d 249, 251, 254 (2d Cir. 2015); *Rose v. Bartle*, 871 F.2d 331, 339 n.3 (3d Cir. 1989); but see *N. Ind. Gun & Outdoor Shows, Inc. v. City of South Bend*, 163 F.3d 449, 453 & n.4 (7th Cir. 1998)).

- Tangential writings by third parties, such as newspaper articles.

If an exhibit contains confidential information, counsel should exercise caution and consider:

- Redacting the information.
- Filing the document under seal.
- Obtaining a protective order. (Fed. R. Bankr. P. 9037(a), (c), (d).)