

The Art of Eliminating a \$13 Million Obligation

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The Chapter 11 plan of Nikola Corporation wiped out the company's obligation to pay \$13 million under a prepetition settlement agreement resolving a securities fraud class action. The result illustrates the power of Bankruptcy Code section 510(b) to transform certain categories of unsecured claims into equity-type claims.

The underlying securities litigation arose from one of the most publicized corporate collapses of the last decade. Nikola was founded with an ambitious vision of developing hydrogen-powered and electric commercial vehicles. For a time, it became one of the market's most celebrated emerging clean-energy companies, achieving a multibillion-dollar valuation despite having only limited commercial operations.

The company's fortunes changed dramatically after a series of public allegations that many of its statements concerning vehicle capabilities, technological achievements, development milestones, and commercial prospects were materially misleading. Investors alleged that they purchased Nikola stock at artificially inflated prices based on those representations. When contrary information became public through a series of corrective disclosures, Nikola's stock price declined sharply, generating substantial losses for shareholders.

A securities class action followed in the United States District Court for the District of Arizona. The class plaintiffs alleged violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5. As is typical in securities fraud litigation, the claimed damages were tied directly to the decline in Nikola's stock price following the corrective disclosures. The theory was straightforward: investors allegedly paid more for Nikola shares than they otherwise would have paid had the market known the truth.

Prior to its bankruptcy filing, Nikola and the class plaintiffs participated in mediation and reached a settlement memorialized in a January 2025 term sheet. Under the proposed settlement, Nikola agreed to pay the class \$13 million in cash together with other consideration. The settlement appeared to transform a disputed securities fraud claim into a fixed contractual payment obligation. Indeed, the settlement term sheet contemplated that if Nikola later filed bankruptcy, it would seek court approval of the settlement under Bankruptcy Rule 9019.

Less than a month later, however, Nikola commenced its Chapter 11 cases. The class plaintiffs filed a proof of claim asserting entitlement to at least the \$13 million. At first glance, the claim appeared stronger than a typical unliquidated securities claim. The parties had already negotiated a resolution, agreed on a payment amount, and documented the settlement terms. Yet bankruptcy law focuses not merely on the form of a claim but on its origin.

That distinction became outcome-determinative.

Section 510(b) requires mandatory subordination of claims "for damages arising from the purchase or sale" of a debtor's securities. Congress enacted the provision to preserve the traditional risk allocation between creditors and shareholders. Creditors bargain for repayment. Equity investors bargain for potential upside while assuming the risk that the enterprise may fail. When an investor's losses stem from ownership or purchase of stock, section 510(b) generally prevents that investor from elevating those losses to parity with ordinary unsecured creditors.

Nikola argued that the class claim, even after settlement, still arose from the purchase and sale of Nikola stock. The settlement had changed the amount of the claim, but not its essential character. The economic injury remained the same: losses allegedly suffered because investors purchased Nikola shares at inflated prices and later experienced a decline in value when the truth emerged. The bankruptcy court agreed, characterizing the claim as a textbook section 510(b) claim seeking damages measured by the diminution in value of the debtor's equity securities.

As a result, Nikola's plan placed the securities settlement claim into a separate subordinated class reserved for claims subject to section 510(b). Because senior creditor classes were not being paid in full, the subordinated class was projected to receive no recovery. A claim that had been negotiated down to a \$13 million settlement and appeared destined for payment outside bankruptcy was relegated to the bottom of the distribution waterfall and effectively eliminated.

The class plaintiffs did not seriously dispute that section 510(b) applied. Instead, they focused on procedure, arguing that Nikola could not subordinate their claim through plan confirmation alone. According to the plaintiffs, the debtor was required to file a formal claim objection or commence an adversary proceeding before subordinating the claim. Both the bankruptcy court and the district court rejected that argument, concluding that section 510(b) subordination concerns priority and treatment rather than claim allowance and that Bankruptcy Rule 7001(h) expressly permits subordination to be implemented through a chapter 11 plan.

The lesson from Nikola is that a settlement agreement may create a contractual right to payment. Still, it does not necessarily erase the nature of the underlying injury that gave rise to the obligation. Where the economic reality remains shareholder loss arising from the purchase or sale of the debtor's stock, section 510(b) may continue to apply. In Nikola, that principle transformed a seemingly fixed \$13 million settlement obligation into a subordinated claim that ultimately recovered nothing.