UNITED STATES SUPREME COURT

2017 CASE REVIEW

LOU JONES BREAKFAST

NOVEMBER 14, 2017

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CASES DECIDED LAST TERM

I. *Czyzewski v. Jevic Holding Corp.,* 137 S. Ct. 973 (2017).

A. Issue: Whether a Chapter 11 case may be terminated by a "structured dismissal" that distributes estate property in violation of the Bankruptcy Code's priority scheme?

B. Facts.

1. Jevic was a trucking company headquartered in New Jersey, which, after a decline in business in 2006, was acquired by a subsidiary of Sun Capital Partners in a buyout financed by CIT Group.

2. Post-acquisition, the company continued to struggle and, after entering into a forbearance agreement, the company notified its employees that the business was closing and that they were terminated as of May 19, 2008. The company filed a Chapter 11 petition on May 20, 2008.

3. Jevic's truck drivers filed a class action suit against Jevic and Sun alleging that there was a violation of the applicable state and federal Worker Adjustment and Retraining Notification ("WARN") acts. The truck drivers prevailed on their claims against Jevic, but not against Sun.

4. In the bankruptcy case, the Committee brought a fraudulent conveyance action against CIT and Sun.

5. The Committee's litigation proceeded for over three years, and in March 2012 representatives of all of the major players, including the truck drivers, met to try to negotiate a settlement to apportion Jevic's remaining assets comprised of $1.7 million in cash (which was subject to Sun's lien) and the suits against CIT and Sun.

6. The Committee, Jevic, CIT and Sun reached a settlement which resulted in the suits being dismissed, and the $1.7 million and an additional $2 million paid by CIT being deposited into an account to pay administrative claims and tax claims, and then unsecured claims on a *pro rata* basis. The case was to be dismissed and the amounts paid in accordance with the settlement to the participating creditors, with nothing paid to the truck drivers.

7. The truck drivers, who asserted a claim of $12.8 million ($8.3 million of which was priority wages), objected to the proposed settlement.

8. The bankruptcy court noted that structured dismissals had been approved in other courts.

9. The court also found that there were insufficient assets to pursue the fraudulent transfer claim, no possibility of a confirmable plan, and that under any other disposition most of the creditors would receive nothing outside the settlement. This warranted approving the settlement.

10. The court concluded that, while plans of reorganizations must follow the absolute priority rule, settlements need not.

11. The truck drivers appealed and requested a stay of the approval order, which was denied by the bankruptcy court. The stay request was not taken to the district court, and the settlement was implemented, with 1,000 checks sent to priority tax and unsecured claim holders. The district court affirmed the order approving the settlement, and the truck drivers appealed.

12. The Third Circuit found that structured dismissals were authorized by the Code, but acknowledged that there was a split in the Circuits regarding whether an order authorizing a structured dismissal could sanction distributions that violated the Code's priority scheme.

13. Admitting it was a close call, the Third Circuit held that strict compliance with the Code's priority scheme was not required where there were "specific justifiable and credible grounds" warranting a deviation, and affirmed the district court.

C. Supreme Court Opinion.

1. Justice Breyer stated that there are three possible outcomes for a Chapter 11 case: a confirmed plan; a conversion to Chapter 7; or a dismissal of the case under § 1112(b).

2. The objective of dismissal is to return to the prepetition financial status quo.

3. Where that is not possible, § 349(b) permits the bankruptcy court "for cause" to alter the dismissal's ordinary restorative consequences by approving a "structured dismissal."

4. In a Chapter 7 case, distributions of the estate's assets must follow the prescribed priority scheme.

5. While the Code provides that distributions pursuant to a Chapter 11 plan may be somewhat more flexible, a plan can't be confirmed over the objection of an objecting class if it proposes priority-violating distributions.

6. However, with dismissal of a Chapter 11 case, the Code does not provide what priority rules, if any, apply to the distribution of the estate assets.

7. After exploring the facts of the case, the Court addressed the petitioners' standing.

8. The Court rejected the respondents' argument that without a violation of the ordinary priority rules there would have been no settlement, and without the settlement the fraudulent conveyance lawsuit had no value. Thus the respondents argued that the petitioners who received nothing in the dismissal suffered no damages because absent the settlement, they would also have received nothing.

9. The Court noted that Sun had already won the WARN suit and that the demand that petitioners be excluded from the distributions under the dismissal was to deprive them of funds to pursue the WARN action. If Sun's reasons for demanding the petitioners receive no distribution disappeared, why, asked the Court, should some of the settlement proceeds go to the petitioners?

10. Moreover, CIT and Sun settled the lawsuit for $3.7 million which made little sense if there was truly no chance of success. Even if there was a chance the suit might prove fruitless, the petitioner's loss of the right to bring the suit on their own was sufficient to cause the Court to conclude that the petitioners had standing.

11. The Court then turned to the principal question: Can a bankruptcy court approve a structured dismissal that provides for distributions that do not follow ordinary priority rules without the affected creditors' consent? The simple answer, said the Court, is no.

12. The priority system of distributions to creditors is fundamental to the Code's operation.

13. If Congress intended structured dismissals to be a backdoor means to achieve the kind of nonconsensual priority violating final distributions that the Code prohibits in Chapter 7 liquidations and Chapter 11 plans, it would have affirmatively said so. ("Congress … does not…hide elephants in mouseholes.").

14. The Chapter 11 dismissal provisions seek a restoration of the prepetition financial status quo. Where this is not possible, for cause, the bankruptcy court can protect the rights acquired in reliance of the bankruptcy case.

15. However, nothing in the Code authorizes a court to approve end-of-case distributions that would be flatly impermissible in a Chapter 7 liquidation or a Chapter 11 plan without the impaired creditor's consent.

16. The Court expressed no view about the validity of structured dismissals in general, and said that non-priority distributions prior to the end of the case and to preserve the debtor as a going concern were not prohibited. For example, first day wage orders, critical vendor orders, financing "roll-ups" and interim distributions of settlement proceeds to fund continuing litigation may be valid.

17. Finally, while acknowledging that the Third Circuit only found structured dismissals permissible in a "rare case" in which the court could find "sufficient reasons" to disregard priority, the Court held that the "rare case" exception would be turned into the general rule which would sow uncertainty, change the bargaining leverage and risk collusion among classes of creditors in many cases.[1]

D. The Dissent.

1. Justice Thomas joined by Justice Alito found that the Court decision did not address the issue framed in the petition for certiorari, which was: Whether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme?

2. Instead, the Court decided a narrower question framed by the petitioners in their subsequent brief: Whether a Chapter 11 case may be terminated by a "structured dismissal" that distributes estate property in violation of the Bankruptcy Code's priority scheme?

3. Justice Thomas said that there were not sufficient Circuit court decisions on this novel question of bankruptcy law, the respondents did not brief the reframed question and the Court's rules (Rule 24.1 and 14.1(a)) prohibited parties from changing the substance of the question presented.

4. Consequently, he would have dismissed the writ as improvidently granted.

II. *Midland Funding, LLC v. Johnson,* 137 S. Ct. 1407 (2017).

[1] Two recent cases have cited *Jevic.* The first, *In re Fryar,* 570 B.R. 602 (Bankr. E.D. Tenn. 2017), declined to approve an interim settlement with a proposed distribution outside of the Code's priority scheme which the court viewed as a preamble to a structured dismissal. The second, *In re Pioneer Health Svcs., Inc.,* 570 B.R. 228 (Bankr. S. D. Miss. 2017), refused to approve a critical vendor motion, finding *Jevic* supported increased scrutiny of such motions.

A. Issues: (1) Whether a debt collector violated the Fair Debt Collection Practices Act ("FDCPA") when it filed an accurate proof of claim in the bankruptcy proceeding for a debt whose collection would now be barred by the statute of limitations; and (2) whether the Bankruptcy Code precludes a lawsuit under the FDCPA on the ground that the defendant debt collector filed a proof of claim for a debt arising beyond the statute of limitations?

B. Facts.

1. Midland, a debt purchaser, acquired Johnson's defaulted credit card account in the amount of $1,870.71.

2. Johnson filed a Chapter 13, and Midland filed a proof of claim which accurately listed the date of the last transaction as May 2003, beyond Alabama's six-year statute of limitations.

3. Johnson objected to Midland's proof of claim, and the bankruptcy court disallowed it.

4. Three days after the disallowance, Johnson sued Midland in federal district court, alleging that because Midland's claim was time-barred, the proof of claim constituted an unfair, deceptive or misleading debt-collection practice under the FDCPA.

5. Granting Midland' s motion to dismiss, the district court found that the statute of limitations does not extinguish a creditor's right to payment, but instead simply eliminates the creditor's legal remedy to obtain a civil judgment.

6. The district court went on to hold that the Code permits a creditor to file a proof of claim for an unextinguished time-barred debt, but noted an irreconcilable conflict between the Code and the FDCPA because, to comply with the FDCPA, the creditor must surrender its rights under the Code. Consequently, the FDCPA must give way to the Code. Johnson appealed.

7. On appeal, the Eleventh Circuit held that while the Code allows all creditors to file proofs of claim in bankruptcy cases, it does not protect them from liability. There was no irreconcilable conflict between the Code and the FDCPA.

8. Any party can file a frivolous lawsuit, but afterwards the filer may face sanctions. Finding that the same is true for the Code and the FDCPA, the Eleventh Circuit reversed.

C. Supreme Court Opinion.

1. The FDCPA prohibits a debt collector from asserting any "false, deceptive, or misleading representation" or using any "unfair or unconscionable means" to collect, or attempt to collect, a debt.

2. Under state laws, such as Alabama's, which determines whether a creditor has a claim (right to payment), a creditor has a right to payment even if the statute of limitations has expired.

3. Johnson's arguments that "claim" means "enforceable claim" and that filing an unenforceable proof is claim is false, deceptive and misleading, are without merit.

4. The word "enforceable" does not appear in the Code. Moreover, §502(b)(1) says that if a claim is not enforceable it will be disallowed, and §105(5)(A) includes in the definition of claim, rights to payment which are disputed.

5. Expired statutes of limitation have long been treated as affirmative defenses.

6. Whether a statement is misleading requires consideration of the legal sophistication of the intended audience. In a Chapter 13, a Chapter 13 trustee is a member of the audience. A trustee is likely to understand that a stale claim is subject to disallowance for untimeliness.

7. Whether Midland's assertion of a time barred claim is "unfair" or "unconscionable" is a closer question.

8. While several lower courts have ruled that any attempt by a debt collector to collect a time barred claim is "unfair," this precedent was in the context of a civil suit where the debtors are unsophisticated, have not retained the requisite records to dispute the claim or might pay the debt to avoid the embarrassment of a suit.

9. These factors are not present in a Chapter 13. The debtor initiates the action and a knowledgeable trustee is available to utilize the procedural rules to object to the time barred claim. Thus, a stale claim will be considerably more likely to be met by resistance, objection and disallowance in a Chapter 13 than in a civil proceeding.

10. The argument of the United States in support of Johnson that unfair conduct is sanctionable is not persuasive. Untimeliness is an affirmative defense and the burden is on the trustee to investigate and object to a stale claim under the Code' s procedures.

11. Assertion and successful disallowance of a stale claim is actually a benefit to the debtor. Upon receiving his or her discharge, the debt, even if unenforceable, will not remain on the debtor's credit report, enhancing the debtor's ability to borrow money, buy a home or secure employment.

12. More importantly, if the affirmative defense of untimeliness is an actionable under the FDCPA, are other affirmative defenses also actionable, or only this one? The Court does not believe that Congress intended civil courts applying the FDCPA to determine the answer to these bankruptcy related questions.

13. The Bankruptcy Code creates and maintains a delicate balance of the debtor's protections and obligations. Finding the FDCPA applicable would upset that delicate balance.

14. Substantively, finding that the FDCPA applicable would authorize a new substantive remedy in the absence of the Code providing for it. Administratively, it would permit post-bankruptcy litigation regarding a creditor's state of mind to prove the violation was intentional. Procedurally, it would require creditors to investigate an affirmative defense that it is the debtor's job to assert and prove.

15. The Court noted that the Advisory Committee on Rules of Bankruptcy Procedure rejected a proposal that would have required a creditor to certify that there is no valid statute of limitations defense.

16. Finally, while one bankruptcy court has found that filing a time-barred claim merits sanctions under FRBP 9011, others have held to the contrary. This caused the Court to be unable to find that filing a stale claim is "unfair" or "unconscionable" under the FDCPA and to reverse the Eleventh Circuit.

D. Dissent.

1. Justice Sotomayor, joined by Justices Ginsberg and Kagan, dissented.

2. Professional debt collectors have built a billion dollar business out of buying stale debts, filing suits and hoping that no one notices that the debt is too old to be enforced. This practice is both "unfair" and "unconscionable."

3. Having been stymied by civil courts finding that such practices violate the FDCPA, debt buyers have moved to a new forum: bankruptcy courts.

4. Debt buyers have deluged the bankruptcy courts with stale claims unenforceable under state law, prompting the Government to sue one debt buyer for abusing the bankruptcy process by "knowingly" and strategically" filing thousands of time-barred claims.

5. Filing a proof of claim for a stale debt is the same as filing a civil action to collect it. Both actions are "unfair" and "unconscionable."

6. Outside of bankruptcy, the debt buyers hope that debtors, who are unaware of the statute of limitations defense, will make a partial payment to avoid a suit and thereby restart the statute of limitations.

7. The same dynamics apply in bankruptcy where unsophisticated debtors and overworked trustees are the only defense to debt buyers who know their claim will be disallowed if

objected to. These debt buyers do not file the claims in good faith, but instead hope that the bankruptcy system will fail. This is "unfair" and "unconscionable" under the FDCPA.

8. The majority finds that commencing a civil action to collect a stale debt violates the FDCPA, but finds seeking the same result in bankruptcy does not.

9. Because of the presence of a Chapter 13 trustee, the majority finds that it is considerably more likely that stale claims will be met with resistance, objection and disallowance. However, those with actual experience insist this is false.

10. The United States, which oversees bankruptcy trustees, asserts that Chapter 13 trustees cannot realistically be expected to identify every time-barred claim. Moreover, objection to such frivolous claims would clog the docket of bankruptcy courts. The National Association of Chapter 13 Trustees, one of the *amici,* agrees, arguing that the practice of filing stale claims is "wasteful" and "exploitive."

11. The majority concludes that because a Chapter 13 debtor commences the case, he or she is more sophisticated than the average consumer debtor. This is rarely the case.

12. Additionally, the majority asserts that the bankruptcy rules help guide evaluations of claims. However, claims not objected to are automatically allowed, making the debtor more vulnerable in bankruptcy to oversights, a fact relied upon by debt buyers.

13. The majority finds that a Chapter 13 debtor benefits if an untimely claims is filed and disallowed because the debt will be discharged. However, if the stale claim is allowed and a payment is made, in many states the debt is resuscitated, making the debtor worse off than he or she was when the entered bankruptcy. Only the debt buyers benefit.

14. The law should not be a trap for the unwary. However, the majority's decision sets such a trap. Perhaps Congress will make explicit what the dissent finds implicit by amending the FDCPA.

III. *Henson v. Santander Consumer USA Ind.,* 137 Sup. Ct. 1718 (2017).

A. Issue: Is a purchaser of a debt who attempts to collect it for its own account a "debt collector" under the Fair Debt Collection Practices Act ("FDCPA")?

B. Facts:

1. CitiFinancial Auto loaned money to the petitioners seeking to buy cars. Petitioners defaulted on the loans. Subsequently, CitiFinancial sold the loans to respondent Santander which aggressively sought to collect the loans.

2. Petitioners asserted that Santander's collection practices violated the FDCPA.

3. The District Court and the Fourth Circuit Court of Appeals held that Santander did not attempt to collect the debt owed to another but instead only sought to collect debts that it purchased and owned, taking its actions was outside the protective ambit of the FDCPA.

C. Supreme Court Opinion.

1. Justice Gorsuch, writing for a unanimous court in his first opinion, began by acknowledging the split in the Circuits, with the Fourth and Eleventh Circuit holding that parties collecting for their own account debts purchased from another are not covered by the FDCPA, and the Third Circuit and the Seventh Circuit ruling the opposite. *See McKinney v. Caldeway Properties, Inc.,* 548 F.3d 496 (7th Cir. 2008).

2. Both sides agree that a third party debt collection agent is "debt collector" under the FDCPA, and one which collects its own debts is not. The question is how to classify those who purchase debt from a third party and seek to collect it.

3. Justice Gorsuch said that the court did not address two related questions: First, whether a party which collected debts it purchased and which also regularly acts as a third party collection agent is covered by the FDCPA? Second, whether the statutory definition of "debt collector" encompasses those engaged in any business the principal purpose of which is the collection of any debts?

4. Examining the language of the FDCPA, it is clear that Congress intended the Act to apply to debts currently owed, not to debts owed to another in the past.

5. For the defendant to be a "debt collector" under the Act, the defendant must be attempting to collect a debt owed to *another*.

6. The court then took up the petitioners' argument that the FDCPA was written before the advent of the market for defaulted debt, which petitioners claim is the most significant change to the debt market since the Act's passage in 1977.

7. Had Congress known this new industry would blossom, argued the petitioners, Congress would have treated defaulted debt purchasers the same as third party debt collection agents.

8. Justice Gorsuch responded: "And while it is our job to apply faithfully the law Congress has written, it is never our job to rewrite a constitutionally valid statutory text under the banner of speculation about what Congress might have done had it faced a question that, on everyone's account, it never faced."

9. Affirming the Fourth Circuit, the court observed that it has "no difficulty imagining, for example, a statute that applies the Act's demands to anyone collecting any debts, anyone

collecting debts originated by another, or to some other class of persons still." However, the proper role of the judiciary is "to apply, not amend, the work of the People's representatives."

CASES TO BE DECIDED THIS TERM

IV. *FTI Consulting, Inc. v. Merit Management Group, LP,* 830 F.3d 690 (7th Cir. 2016).

A. Issue: Does the Code §546(e) safe harbor insulate a leveraged buyout between two private parties from avoidance as a fraudulent transfer, if the sale proceeds are paid through a financial institution that acts only as a conduit?

B. Facts.

1. The owners of two privately owned entities operating race tracks were competing for a license to operate a "racino" (combination race track and casino).

2. Rather than fight over the license, one of the parties, Valley View Downs LP ("Valley View"), acquired all of the shares of the other, Bedford Downs Mgmt. Corp, with the sale proceeds being paid through Credit Suisse and Citizens Bank of Pennsylvania to the seller. The acquirer borrowed money from several banks to accomplish the acquisition.

3. After the acquisition, the acquirer failed to obtain one of the necessary licenses and subsequently filed Chapter 11.

4. FTI, as trustee of a Chapter 11 litigation trust, brought suit against Merit Management Group, LP ("Merit"), one of the selling shareholders, alleging that the acquisition was a fraudulent transfer avoidable under §§ 548, 544 and 550.

5. The district court found that the transfers were "settlement payments" made "in connection with a securities contract."

6. Further, the involvement of Citizens Bank caused the payments to be "made by or to" a financial institution, and therefore the transaction was within the § 546(e) safe harbor and not avoidable. The district court granted judgement on the pleadings in favor of Merit, and FTI appealed.

C. The Seventh Circuit opinion.

1. The court started with analysis of the language of the statute. The court agreed with FTI's argument that the statutory language is not dispositive.

2. For example, a post card sent in the mail could be said to be sent "by" the Postal Service or "by" the sender. Similarly, when a person's payment of a bill is made by electronic bank transfer, the payment could be said to have been made "by or to a financial institution" or made "by or to" the recipient of the payment.

3. The 2006 addition to § 546(e) of the language "or for the benefit of" in the clause "…a settlement payment…made by or to (or for the benefit of)…." the named parties, is also ambiguous.

4. The court concluded that the language of the statute standing alone did not point the court in one direction or the other.

5. Is the statute, asked the court, intended to include intermediaries, or are its protections limited to real parties in interest?

6. FTI argued that Chapter 5 of the Code creates a system for avoiding a transaction and a safe harbor from avoidance. It therefore makes sense to understand that the safe harbor only applies to transfers that are eligible for avoidance in the first place.

7. Merit argued that the use of the words "incurred by" in §§ 544, 547 and 548, instead of the words "made by" in §546(e), refutes the argument that §546(e) was only intended to protect transfers made by a debtor.

8. The court concluded that the payment in question was not made on behalf of a debtor by a third party, but was made by the debtor using the bank as a conduit.

9. Additionally, the safe harbor in §548(a)(2) exempting charitable contributions from avoidance has to be read to apply to payments "by" the debtor, even if the payments are made by check or wire transfer. Otherwise, all such payments would be avoidable.

10. Similarly, §555, preventing the application of the automatic stay to termination of securities contracts by counterparties, applies only to the named counterparty and not to a conduit or bank for a counterparty.

11. In those instances, the court concluded that it is the economic substance of the transaction that matters and that § 546(e) should apply in the same manner.

12. Section 546(e) was enacted to protect the markets from systemic risks, and to prevent one large bankruptcy from rippling through the securities industry. The defendants here were not parties in the securities industry. Instead, they were simply corporations that wanted to exchange money for privately held stock.

13. The court ultimately found that § 546(e) does not provide a safe harbor against avoidance of transfers between non-named entities where a named entity acts only as a conduit.

14. The Seventh Circuit noted that, while the Eleventh Circuit in *Matter of Munford,* 98 F.2d 604 (11th Cir. 1996), agrees with its conclusion, five other circuits have interpreted §546(e) to include the conduit situation. *See In re Quebecor World (USA) Inc.,* 719 F.3d 94 (2d Cir. 2013); *Contemporary Indus. Corp. v. Frost,* 564 F.3d 981 (8th Cir. 2009); *In re QSI Holdings, Inc.,* 571 F.3d 545 (6th Cir. 2009); *In re Resorts Int'l. Inc.,* 181 F.3d 505 (3d Cir. 1999); *In re Kaiser Steel Corp.,* 952 F.2d 1230 (10th Cir. 1991).

15. The petition for certiorari was granted on May 1, 2017, and oral arguments were scheduled for November 6, 2017.

D. The position of petitioner Merit Management.

1. Section 546(e), which was amended by Congress over a twenty year period, is broadly written and the clearly prohibits a trustee from avoiding a transfer made by or to a financial institution, even if the transfer is not for the benefit of the financial institution.

2. A judicially imposed non-conduit requirement before the safe harbor would apply would render the inclusion of securities clearing agencies in the safe harbor meaningless.

3. The Seventh Circuit conflated the concepts of the entity that a transfer is made "to" under §546(e) and the "initial transferee" under § 550(a).

4. Had Congress wanted to protect conduit financial institutions, it could have placed a prohibition on recovery in § 550. Instead, Congress put the safe harbor in § 546(e) and precluded the trustee from avoiding the transfer in the first place.

5. A beneficial-interest requirement before the safe harbor would apply would introduce uncertainty in the financial markets. If the beneficial-interest requirement were adopted, substantial litigation would ensue regarding trust companies, indenture trustees and mutual funds.

E. The position of respondent FTI Consulting.

1. Section 546(e) does not bar avoidance of the transfer by the buyer (debtor/Valley View) to seller (Merit) that the trustee seeks to avoid. The Seventh Circuit had it right--§ 546(e) applies only to transfers that are avoidable in the first place, not to transfers by non-debtors that the trustee could never avoid.

2. The language of the section commencing with "Notwithstanding" that a transfer is otherwise avoidable under §§ 544, 545, 547 or 548(b) is evidence that the safe harbor applies to the principal transfer not to the component transactions by which the principal transactions is executed, which are typically done by non-debtors and not avoidable in the first instance.

3. The Seventh Circuit's analysis of § 548(a)(2)(B) was correct. Subdividing the components of a charitable contribution would mean that gifts made by check or wire transfer would be made "by" a financial institution and not protected from avoidance. This can't be what Congress intended.

4. Similarly, § 555, which is an exception to the Code's prohibition against *ipso facto* clauses for counterparties to a securities contract, enumerates the same six entities specified in § 546(e).

5. It makes no sense to think that Congress intended to limit § 555's protection only to the enumerated parties while at the same time extending to *all* parties who receive a pre-bankruptcy payment in connection with a securities contract merely because the payment was made by or through a financial institution.

6. Section 550 permits a trustee to recover from a "transferee" defined by the courts as a party who has "dominion" or "control" over the transferred property, not merely a financial intermediary or conduit. Merit asks the court to treat the Code's avoidance and recovery provisions as distinct concepts. Sections 546(e) and 550 are closely related and must be read together.

7. Section 546(e) has its origins in Congress' desire to protect the securities market from systemic risks. However reading the section as Merit proposes, § 546(e) would shield "countless constructively fraudulent transfers that harm innocent creditors while posing no material, let alone systemic, risk to the securities market."

8. The only transfer the trustee seeks to avoid is the one from the debtor Valley View, a buyer, to Merit, a seller. The trustee does not seek to avoid the intermediate transactions through which the Valley View to Merit transfer was executed, e.g., through the financial institutions.

9. There was only one transfer here. : Not a series of transfers as Merit argues. It makes no sense to read § 546(e) as requiring that single transfer to be subdivided into its constituent parts.

F. The brief of *Amicus* Opportunity Partners, L.P., in support of Merit.

1. Section 548(a)(1) of the Code authorizes the trustee of an insolvent estate to avoid certain transfers. However, this does not mean the estate automatically satisfies Article III of the Constitution's standing requirements.

2. Among the standing requirements is that there be an injury that is traceable to the putatively illegal challenged of the defendant.

3. Merit was a passive shareholder which, by receiving payment for its shares pursuant to an arm's length transaction, did nothing wrong. FTI has failed to meet its burden that it has standing to pursue Merit.

1. The brief of *Amici* Former Shareholders of Tribune and Lyondell in support of Merit.

    1. *Amici* are defendants in constructive fraudulent transfer actions bought in bankruptcy cases. While the courts in those cases have ruled that § 546(e) bars the actions, there is a pending petition for certiorari in the *Tribune* case and the district court in *Lyondell* is awaiting the outcome of this case before deciding upon the bankruptcy court's recommendation.

    2. Complex transactions, such as Tribune's and Lyondell's, utilizing numerous securities clearing agencies, involving thousands of shareholders, including mutual funds, retirement plans and billions of dollars vividly demonstrate why Congress enacted § 546(e). Failure to apply the section as it is written would destabilize the financial markets constricting sales of securities by replacing finality with uncertainty.

    3. The Seventh Circuit's excessive reliance on the facts of a small private market transaction ignored the implications to the public markets in large, complex securities transactions. This narrow reading threatens the stability of the securities markets and discourages investment.

    4. The text and the structure of the statute clearly applies where a financial institution is only acting as an intermediary. The Seventh Circuit would require that only transactions "for the benefit of" financial intermediaries could rely on the safe harbor, rendering the words "by" or "to" superfluous.

    5. At a minimum the Court should reserve its decision on § 546(e)'s application to transactions settled through the public company clearing and settlement system.

2. The brief of *Amici* Tribune Company Retirees and Noteholders in support of FTI.

    1. Section 546(e) only applies where the debtor or the transferee the trustee seeks to recover from is an entity that is a covered entity. It does not protect transfers that simply pass *from* a debtor *through* a financial institution *to* the creditor. To be

avoidable, a transfer must be by the debtor to an ultimate transferee. A financial institution which serves as a conduit is neither.

2. Merit assumes that what a trustee seeks to avoid is not a single transfer but the entire series of transfers in a transaction, many through intermediaries. This reading would render many sections of the Code illusory, such as §§ 547(b)(4)(B) (transfers to insiders) because the transfer to the insider would be from an intermediary and not the debtor, and 550(b) (good faith defense of mediate transferees) because almost everyone in the transfer chain would be a mediate transferee.

3. The problem § 546(e) addresses is not implicated where neither the debtor nor the transferee from whom the trustee seeks to recover is a "covered entity."

4. Congress did not enact § 546(e) to protect investors enriched through fraudulent transfers, but instead to protect financial institutions from the risk that the bankruptcy of one financial institution will spread to another.

5. While Merit contends that the non-conduit requirement would render the inclusion of securities clearing agencies meaningless, the statute would protect securities clearing agencies if the trustee sought recovery from the securities clearing agencies directly, as Congress intended. However, it would not protect the ultimate recipient of the transfer if the securities clearing agencies merely "handled " the funds, also as Congress intended.

3. Brief of *Amicus* National Association of Bankruptcy Trustees in Support of FTI.

   1. To maximize distributions to creditors, Congress armed trustees with the strong arm powers in Chapter 5 of the Code to avoid precisely this type of constructively fraudulent transaction. Contextually, § 546(e) rests comfortably among the avoidance powers in Chapter 5, rather than presenting as a misplaced provision of the Securities Exchange Act making inviolate the stock trades of shareholders.

   2. Section 546(e) was enacted to provide belt and suspenders protection to securities clearinghouses, which it does. It was not intended displace the avoidability of the underlying debtor-to-ultimate-recipient transfer.

   3. To read § 546(e) as applying to a series of intermediate transfers rather than a single transfer from the buyer to the seller through conduit intermediaries would vitiate § 550 making recovery of avoidable transfers rare.

   4. *Jevic* underscores the importance of the Code's priority scheme. Under Merit's reading of § 546(e), the selling shareholder beneficiaries of constructively fraudulent leveraged buyouts ("LBO's") would receive all of the benefits leaving trade creditors,

bond holders, employee pension plans, retirement plans, mutual funds and other entities with little or nothing. This stands the Code's priority scheme on its head.

5. Merit and the *amici* over-emphasize LBO's of large public corporations. Most LBO's are private transactions. Between 1995 and 2004, LBO's of private companies accounted for 90% of the transactions and 80% of the transaction value (declining to 66% during the following three years). Consequently, this case should not be decided with a focus on public companies.

6. There is no evidence that Congress intended to favor shareholders by making their stock trades unassailable instead of maximizing the recovery to the debtor's creditors.

4. Brief of *Amici* Bankruptcy Law Professors in Support of FTI.

   1. To understand the safe harbor to avoidability in section 546(e), one must focus on the transaction unit at issue--the transfer (the parting of an interest in property) from the buyer to the seller, the beneficiary of the transfer.

   2. If the "transfer" sought to be avoided is to or for the benefit of a protected securities intermediary and is a settlement payment made in connection with a securities contract, § 546(e) provides a complete defense to avoidance.

   3. If the "transfer" sought to be avoided is not one to a financial intermediary, § 546(e) should provide no protection to the transferor and ultimate transferee, here Valley View and Merit. To read the statute otherwise would be nonsensical. It would shield from avoidance a "transfer" that is *not* being challenged.

   4. Congress understood that allowing the avoidance of any margin or settlement payments that passed through the hands of a bankrupt financial intermediary would create an unacceptable "systemic risk" to the securities markets.

   5. There is no such systemic risk when there is no bankruptcy of a financial intermediary and neither the debtor (whose trustee seeks to recover a payment made by the debtor), nor the defendant (from whom the recovery is sought as the party to whom the transfer is ultimately made) is a protected financial intermediary.

   6. The Seventh Circuit's is the only rational and practical reading of § 546(e). The Circuit Courts holding to the contrary viewed § 546(e) in isolation, relying on the invocation of "plain" meaning without engaging in the analysis of the underlying transfer actually involved.

V. *U.S. Bank, N.A. v. The Village of Lakeridge, LLC (In re The Village of Lakeridge, LLC),* 814 F.3d 993 (9th Cir. 2016).

A. Issue: Whether the appropriate standard of review for determining non-statutory insider status is the *de novo* standard of review applied by the Third, Seventh and Tenth Circuits, or the clearly erroneous standard of review adopted by the Ninth Circuit in this case.

B. Facts.

1. U.S. Bank held a fully secured $10 million claim against the debtor Lakeridge which had proposed a Chapter 11 plan. The only other creditor was MBP Equity Partners I, LLC ("MBP") the sole member of the debtor, which held an unsecured claim of $2.6 million.

2. MBP had five directors, one of which was Kathie Bartlett, who had a close business and personal relationship with Dr. Robert Rabkin. After filing its claim, MBP sold the claim to Rapkin for $5,000. The bank moved to designate Rabkin's claim and disallow it for plan voting purposes contending that Rabkin was a statutory insider and a non-statutory insider because the claim was conveyed in bad faith.

3. The bankruptcy court found that Rabkin was not a non-statutory insider because he did not purchase it in bad faith. However, the court designated Rabkin's claim as a statutory insider because he acquired it from an insider. The Ninth Circuit BAP affirmed the decision with respect to the non-statutory issue and reversed the finding that Rabkin acquired insider status by purchasing the claim from an insider.

4. Finding that non-statutory status is a question of fact, the Ninth Circuit reviewed the factual findings for clear error, and finding none, affirmed.

C. U.S. Bank's Petition for Certiorari and Position.

1. The Petition asked the Court to consider three issues: (a) whether the assignee of and insider acquires the insider's status and is not allowed to vote on a Chapter 11 plan; (b) is *de novo* or clearly erroneous the appropriate standard of review; and (c) whether the proper test for non-statutory insider status requires an "arm's length" analysis as applied by the Third, Seventh and Tenth Circuits, or a "functional equivalent" test which looks to the factors comparable to those enumerated for statutory insider status as applied by the Ninth Circuit in this case.

2. The Supreme Court granted certiorari on March 27, 2017 as to issue (b) only.

3. The bankruptcy court selected five factors to determine whether MBP and Rabkin's relationship was sufficiently close to warrant non-statutory insider status, but failed to determine whether the transaction was "arm's length."

4. This case presents a mixed question of law and fact which requires a *de novo* rather than a clearly erroneous standard of review.

5. Under each of the four tests previously applied by the Supreme Court, the decision here merits *de novo* review:

    a. Where the mixed issue is predominantly legal, under the predominance of law or fact test, the issue is *de novo.*

    b. Where the majority rule among the circuits supports a *de novo review,* the historical practice test warrants a *de novo* review.

    c. The need for uniform standards and consistent outcomes under the functional considerations test mandates *de novo* review.

    d. Where the determination of insider status resolves the ultimate issue in the case, the ultimate issue test also compels a *de novo* review.

D. The Position of Respondent The Village of Lakebridge, LLC.

1. Whether a specific person qualifies as a non-statutory insider is not a mixed question, but instead is entirely a question of ultimate fact.

2. The Ninth Circuit was charged to determine whether the specific transaction was conducted at arm's length. This requires case-by-case decisions based upon the totality of the circumstances measured against a clear standard. The decision turns on whether the clear standard of arm's length dealing was factually satisfied.

3. Even if non-statutory insider status is a mixed question of law and fact, the decision should be affirmed because the trial court is better positioned than the appellate court to decide the issue.

4. Deferential review promotes the efficient use of scarce funds in bankruptcy, while advancing the Code's interest in the expeditious and economical resolution of the case.

5. There are not four tests as petitioner suggests, but only a single framework with multiple steps.

E. Brief of *Amicus* United States Supporting The Village of Lakebridge, LLC.

1. The determination of whether a particular person has insider status involves both legal and factual components, each with separate standards of review.

2. Legal determinations are subject to *de novo* review. An inquiry into whether a transaction was conducted at arm's length should be reviewed for clear error.

3. Appellate courts have long accorded deference to trial-court findings about the arm's length nature of transactions.

4. *De novo* review would provide few law clarifying benefits in the context of determining non-statutory insider status. Trial courts facing the issue would "confront multifarious, fleeting, special, narrow facts that utterly resist generalization." Searching appellate review of such case-specific decisions would add little clarity to the issue.

5. Other Code provisions, which restrict an insider's role in the plan confirmation process, such as requiring that the plan not be proposed in bad faith (§1129(a)(3)), that the plan be in best interests of creditors(§1129(a)(7)), that the plan be feasible (§1129(a)(11)) and requirement that the plan not discriminate unfairly and be fair and equitable (§1129(b), mitigate petitioner's concern that a deferential review of a creditor's arm's length status will result in an unfair advantage for debtors at the expense of creditors.

CASE IN WHICH CERTIORARI WAS GRANTED AND THEN DISMISSED AS IMPROVIDENTLY GRANTED

VI. *PEM Entities, LLC v. Levin,* 655 F. App'x 971 (4th Cir. 2016).

A. Issue: Whether bankruptcy courts should apply a federal rule of decision (as five circuits have held) or a state law rule of decision (as two circuits have held) when deciding to recharacterize a debt claim in bankruptcy as a capital contribution.

B. Facts:

1. The debtor, Province Grande Olde Liberty, was in default to its lender, Paragon Commercial Bank, with respect to an approximate $7 million loan secured by the Olde Liberty Club, a golf course and the debtor's principal asset.

2. After the loan went into default, PEM Entities, LLC ("PEM") purchased the loan, which was in foreclosure, for $1.25 million. The purchase price was provided by capital contributions from two members of the debtor, and loans from Paragon (the selling lender) and two private individuals, which loans were secured by subordinate mortgages on the property.

3. The debtor filed a Chapter 11 proceeding, listing PEM on its schedules as a secured creditor with a claim of $7 million.

4. Two creditors ("Respondents") filed an adversary proceeding naming the debtor and PEM as defendants, seeking to (a) equitably subordinate PEM's claim, (b) have the

claim recharacterized as equity under § 105(a), and (c) recover a prepetition payment to PEM as fraudulent transfer.

5. The bankruptcy court held it had no basis to equitably subordinate PEM's claim and that the Respondents lacked standing to pursue the fraudulent transfer claim.

6. However, the bankruptcy court recharacterized PEM's claim as equity applying the Fourth Circuit's federal rule of decision.[2]

7. PEM appealed to the district court, asserting that the North Carolina state rule of decision, rather than the federal rule of decision, should have been applied. The district court affirmed the bankruptcy court. PEM appealed to the Fourth Circuit which also affirmed.

8. The debtor confirmed a plan in reliance upon the Fourth Circuit's decision subject to that decision being upheld on appeal, giving the debtor a stake in the PEM's claim being recharacterized.

9. PEM petitioned for certiorari, which was granted on June 27, 2017. The debtor was listed as a defendant in the underlying adversary proceeding, but was not a party in the Supreme Court appeal.

10. After the petition was granted, a related state court lawsuit involving the same parties was settled, and the financial interests of the Respondents were acquired by an individual who had a capital interest in both PEM and the debtor. The settlement agreement provided that only the debtor had the right to defend the pending Supreme Court case.

11. Asserting that the debtor was the proper party with an interest to defend the appeal in order to perform its confirmed plan, on July 21, 2017 PEM and the debtor filed a joint motion to confirm the debtor's status as a party.

12. However, apparently reluctant to run the risk of hearing argument and then having to dismiss the case, on August 10, 2017 the Court dismissed the petition as improvidently granted.

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[2] The Fourth Circuit utilized the Sixth Circuit's eleven factor test for recharacterization set forth in the *Autostyle* decision: (1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of payments; (5)the adequacy of consideration; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments.

13. One commentator has suggested that, whether intended in this case or not, purchasing claims may be a technique available to respondents to have petitions for certiorari dismissed after a grant.