AMERICAN COLLEGE OF BANKRUPTCY
2017 INDUCTION EDUCATION SESSIONS

Supreme Court Update and Outlook
Friday March 10, 2017

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No. 15-649

IN THE

Supreme Court of the United States

CASIMIR CZYZEWSKI, *et al.*,

Petitioners,

v.

JEVIC HOLDING CORP., *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF FOR PETITIONERS

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QUESTION PRESENTED

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.

PARTIES TO THE PROCEEDING

Petitioners, appellants below, are Casimir Czyzewski, Melvin L. Myers, Jeffrey Oehlers, Arthur E. Perigard, Daniel C. Richards, and a certified class of all others similarly situated.

Respondents, appellees below, are Jevic Holding Corp.; Jevic Transportation, Inc.; Creek Road Properties, LLC; the CIT Group/Business Credit, Inc.; Sun Capital Partners, Inc.; Sun Capital Partners IV, LP; Sun Capital Partners Management IV, LLC; and the Official Committee of Unsecured Creditors.

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BRIEF FOR PETITIONERS

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-32a) is reported at 787 F.3d 173. The opinion of the district court (Pet. App. 35a-43a) is unreported but available at 2014 WL 268613. The opinion of the bankruptcy court (Pet. App. 53a-66a) is unreported.

JURISDICTION

The court of appeals entered judgment on May 21, 2015, and denied a timely petition for rehearing en banc on August 18, 2015. Pet. App. 1a, 67a-68a. Petitioners filed a timely petition for certiorari on November 16,

2015, which this Court granted on June 28, 2016. The Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTES AND RULES INVOLVED

The appendix reproduces §§103, 105, 349, 363, 507, 726, 1112, and 1129 of the Bankruptcy Code (11 U.S.C.) and Federal Rule of Bankruptcy Procedure 9019.

INTRODUCTION

Petitioners represent a certified class of nearly 1,800 truck drivers who were fired without warning when their employer, Jevic Transportation, filed for Chapter 11 bankruptcy. As a result of their sudden termination, the drivers had claims against Jevic's bankruptcy estate that were entitled to priority under the Bankruptcy Code. Yet the drivers received nothing for those claims, even though lower-priority general unsecured creditors were paid by the estate. That outcome would have been impermissible in a Chapter 11 plan or a Chapter 7 liquidation. The bankruptcy court allowed it here as part of a so-called "structured dismissal" that approved a settlement of the estate's pending claims against its two largest creditors; distributed the settlement proceeds in violation of the Code's priority scheme, deliberately skipping over petitioners; and dismissed the Chapter 11 case. The Bankruptcy Code does not permit that result.

The Bankruptcy Code establishes a comprehensive process for distributing the value of a business when its assets may be insufficient to pay all creditors in full. Under either Chapter 7 or Chapter 11, that value is distributed according to a strict and detailed scheme of priority. Secured creditors are paid first, up to the value of their collateral and in accordance with the priority of their liens; unsecured creditors are paid next; and

equity-holders receive value only after creditors are paid in full. As among unsecured creditors, the Bankruptcy Code grants priority to specific categories of claims, including the employee claims at issue here, which must be paid in full before unsecured creditors without priority—general unsecured creditors—are paid anything. In a Chapter 7 liquidation, this order of priority cannot be varied. In a Chapter 11 plan, it can be varied only with the affected creditors' consent. As the Court has repeatedly recognized, this priority structure is the backbone of Chapter 11 and the ultimate safeguard of bankruptcy's core purpose to distribute a debtor's value fairly among its stakeholders.

A debtor can be reorganized under Chapter 11 only through a plan, which must satisfy detailed substantive and procedural requirements—including compliance with priority. Not uncommonly, as here, businesses seek protection under Chapter 11 and then prove unable to confirm a plan. When that happens, the Bankruptcy Code provides two options: The court may either convert the case to Chapter 7, where the debtor's assets are liquidated and distributed according to priority, or dismiss the case, in which event the parties revert to their prebankruptcy positions and creditors can pursue the debtor outside bankruptcy to collect on their claims. Nothing in the Bankruptcy Code contemplates or suggests that a failed Chapter 11 case can be resolved through a "structured dismissal" that distributes the debtor's assets, yet ignores the Bankruptcy Code's requirements for doing so. Basic principles of statutory construction compel the conclusion that Congress did not spell out a mandatory priority scheme in granular detail while at the same time silently conferring the power to disregard that scheme when it proves inconvenient.

The courts below approved the structured dismissal, calling this a "rare" case, because the senior creditors claimed they would not settle if petitioners received any of the settlement proceeds. Of course, there is no way to know whether the parties would have settled had they been required to respect priority. But setting that aside, some parties to a Chapter 11 case may stand to benefit from violating priority and may be able to reach a deal more easily if they are permitted to do so. That is precisely why the Bankruptcy Code requires strict adherence to priority—so that senior creditors will not collaborate with junior creditors or equity-holders to squeeze out disfavored intermediate creditors, as happened here. If a bankruptcy court can approve a structured dismissal violating the priority rights of an objecting creditor because other parties assert that they cannot reach a deal if that creditor's priority is respected, bargaining in every Chapter 11 case will be compromised because it will no longer take place against the backdrop of a clear legal rule. The priority-violating structured dismissal the courts approved here thus undermines the very core of Chapter 11 as Congress envisioned it.

STATEMENT

I. STATUTORY BACKGROUND

A. The Structure And Purpose Of Bankruptcy

The basic function of business bankruptcy law is the creation of an orderly process for distributing an insolvent corporation's value among its creditors. Outside bankruptcy, when a corporation's assets are insufficient to pay all the claims against it in full, there is a danger that creditors will not be treated fairly. For instance, a debtor might seek to pay off favored creditors, or the prospect of insolvency could precipitate a race to

the courthouse, in which creditors who win the race are paid and those who lose the race are not. That in turn can result in the piecemeal dismemberment of the debtor's business and the loss of any going-concern value the business may have, which can reduce the total recoveries for creditors as a group. *See, e.g.*, Jackson, *The Logic and Limits of Bankruptcy Law* 7-19 (1986).

The Bankruptcy Code's response to this problem is to establish a distribution scheme that is "designed to enforce a distribution of the debtor's assets in an orderly manner in which the claims of all creditors are considered fairly, in accordance with established principles rather than on the basis of the inside influence or economic leverage of a particular creditor." H.R. Rep. No. 103-835, at 33 (1994); *see also, e.g.*, Baird, *Elements of Bankruptcy* 59 (6th ed. 2014).

The Code accomplishes this end through several interlocking devices. When a debtor files a petition for bankruptcy, an estate is created comprising all the debtor's prepetition property, tangible and intangible, and any proceeds of that property. §541(a).[1] The bankruptcy trustee or (in most Chapter 11 cases) the debtor-in-possession is required to manage that property for the benefit of the creditor group as a whole, §§704, 1106, 1107(a), and can recover certain payments the debtor made or assets it transferred before bankruptcy that unfairly preferred particular creditors (preferences), §547, or for which the debtor did not receive fair value in return (fraudulent transfers), §§544, 548.

[1] All statutory citations are to the Bankruptcy Code (11 U.S.C.), unless otherwise noted.

The bankruptcy filing also gives rise to an "automatic stay" of any actions by creditors to seize estate assets or to collect on claims against the debtor that arose before the filing. §362(a), (c). By halting collection activities during the bankruptcy, the automatic stay ensures that the estate's value can be maximized and distributed fairly among creditors in accordance with the Code's priority scheme. Creditors can file claims against the estate, which are typically allowed or disallowed—that is, held valid or invalid—according to nonbankruptcy law. §§501, 502.

There are two types of business bankruptcies: liquidation under Chapter 7 and reorganization under Chapter 11. Chapter 7 is designed for circumstances in which the debtor's business cannot be rehabilitated. A Chapter 7 trustee will liquidate the assets of the estate and distribute them to creditors according to specific and unvarying rules of priority, set out in part in §507 of the Bankruptcy Code and described further below. §§704(a), 724, 726.

Chapter 11 is more complex and is typically used when there is a prospect of reorganizing the debtor's business and continuing it as a going concern after the bankruptcy (although Chapter 11 may also be used to liquidate a debtor's business). Chapter 11 recognizes that some debtors may have a business that is suffering from temporary financial distress but can be saved if that distress is resolved. Preserving a debtor's business, in turn, can benefit creditors because a business is typically worth more as a going concern than as a piecemeal collection of assets, and that "going-concern surplus" can be distributed to creditors in satisfaction of their claims. *See, e.g.*, Jackson 14. Unlike in Chapter 7, in Chapter 11 the debtor's management usually remains in place and operates the business during the

bankruptcy case, taking on the obligations of a bankruptcy trustee. §1107(a). And, unlike in Chapter 7, the debtor-in-possession and the various stakeholders can negotiate with one another over how best to maximize the value of the debtor's business (whether in a traditional reorganization or through a sale and liquidating plan), and creditors can consent to different treatment than the Bankruptcy Code would otherwise require if they determine it is in their interest to do so.

The culmination of the Chapter 11 process is the plan, which governs the distribution of the value of the estate to stakeholders. The plan process gives creditors numerous substantive and procedural protections. Most significantly, absent creditors' consent to different treatment, a plan must comply with the Bankruptcy Code's priority scheme, as described below. §1129.

The goal of a Chapter 11 case is usually confirmation of a plan of reorganization, following which the reorganized debtor emerges from bankruptcy protection unencumbered by its prebankruptcy obligations, except as provided in the plan. §1141(d). However, Chapter 11 debtors who are unable or do not want to reorganize may liquidate and distribute the resulting value through a liquidating Chapter 11 plan. §1123(b)(4). In such cases, the debtor does not receive a discharge of any debt, §1141(d)(3), but the requirements of §1129, including compliance with priority, must still be met.

Sometimes Chapter 11 debtors are unable to confirm any plan. For instance, a debtor may be unable to comply with the Bankruptcy Code's requirement that administrative and priority claims be paid in full on the effective date of the plan, §1129(a)(9)—a circumstance known as "administrative insolvency." In such circumstances, the Code provides that the Chapter 11 case is

either converted to Chapter 7—where the estate will be liquidated and distributed as described above—or dismissed. §1112(b). If the case is dismissed, unless the court orders otherwise "for cause," estate property is returned to the debtor, and creditors can once again pursue the debtor and its assets for payment on their claims outside bankruptcy. §349(b).[2]

B. The Priority Scheme

The Bankruptcy Code's priority scheme is central to both Chapter 7 and Chapter 11. Higher-priority claims are entitled to be paid in full before lower-priority claims are paid anything—a system often likened to a waterfall, in which payments cascade down to lower levels only after higher-priority claims are fully satisfied. *See, e.g.*, 4 *Collier on Bankruptcy* ¶507.02[1] (16th ed. 2016); 3 *Norton Bankruptcy Law and Practice* §49:1 (3d ed. 2016).

The overall priority scheme in bankruptcy is a function of both bankruptcy and nonbankruptcy law. In

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[2] In recent years, it has become increasingly common for failed Chapter 11 cases to be resolved by "structured dismissals," in which the order dismissing the case is accompanied by other ancillary relief. *See* American Bankruptcy Institute Commission To Study the Reform of Chapter 11, *2012-2014 Final Report and Recommendations* 269-271 (2014) (enumerating common features of structured dismissals). While structured dismissals have occasioned some controversy, this case does not present the question whether structured dismissals are ever permissible. To the extent that structured dismissals are consensual and consistent with the Bankruptcy Code, they might be an appropriate exercise of the court's equitable authority. The narrow question here is only whether a nonconsensual structured dismissal can distribute the value of the bankruptcy estate in a way that violates the Code's priority scheme.

Chapter 7, that priority scheme cannot be altered. As they would be outside bankruptcy, secured creditors are entitled to be paid first from the proceeds of their collateral, according to the priority of their liens. §§103(a), 361, 362(d), 363(e), 725. Unsecured creditors are then paid according to a carefully delineated statutory scheme of priority, set out in §507 of the Bankruptcy Code. §726(a)(1). Unsecured creditors without priority—"general unsecured creditors"—are paid only after priority unsecured creditors. §726(a)(2). Equity-holders receive nothing unless all creditors are paid in full. §726(a)(6).

As noted above, Chapter 11 plans permit creditors to consent to deviations from priority. Absent consent, however, Chapter 11 plans are governed by the principle of "absolute priority," under which junior classes of claims cannot receive anything until senior classes of claims are paid in full, and equity-holders cannot retain any value unless all creditors are paid in full. *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 202 (1988). That principle is codified in §1129(b) of the Bankruptcy Code through the requirement that plans must be "fair and equitable" to nonconsenting classes of claims. §1129(b)(2)(A) (defining "fair and equitable" for classes of secured claims); §1129(b)(2)(B) (defining "fair and equitable" for classes of unsecured claims).

Chapter 11 plans must also abide by the statutory priorities for unsecured creditors set out in §507. Absent consent, priority unsecured creditors must be paid in cash in full, in most cases on the effective date of the plan. §1129(a)(9). Section 507 currently contains ten categories of unsecured claims accorded priority because of their "special social importance," S. Rep. No. 95-1106, at 4 (1978), or their critical role in facilitating the resolution of a bankruptcy case. Priority is afford-

ed to, for example, expenses incurred in administering the bankruptcy estate, §507(a)(2), and many federal, state, and local taxes, §507(a)(8).

Petitioners in this case have claims against Jevic for severance pay for firing them without warning immediately before the bankruptcy. Those claims are entitled to priority under the Bankruptcy Code, which grants priority to certain unpaid employee wages and benefits, including severance pay. §507(a)(4), (5). Congress established those priorities "to alleviate in some degree the hardship that unemployment usually brings to workers and their families" when a business enters bankruptcy. *United States* v. *Embassy Rest., Inc.*, 359 U.S. 29, 32 (1959); *see also Howard Delivery Serv., Inc.* v. *Zurich Am. Ins. Co.*, 547 U.S. 651, 658-659 (2006). Indeed, "[e]mployees are usually the hardest hit financially by a bankruptcy," as they often have no other source of income. 4 *Collier* ¶507.06[1]. The wage priority is also an important inducement to employees not to "abandon a failing business for fear of not being paid," which would imperil the chances of rehabilitation and worsen the prospects of repayment for all other creditors. H.R. Rep. No. 95-595, at 187 (1977). Accordingly, either in Chapter 7 or (absent consent) under a Chapter 11 plan, priority claims for unpaid wages and employee benefits must be paid in full before general unsecured claims are paid anything.

II. THE JEVIC BANKRUPTCY

A. Jevic's Bankruptcy Filing And The Fraudulent Transfer Suit

1. The debtor in this Chapter 11 case, Jevic Transportation, was a New Jersey-based trucking company. Pet. App. 2a. In 2006, Sun Capital Partners, a private equity firm, acquired Jevic in a leveraged

buyout. *Id.* In substance, Sun financed the acquisition of Jevic by borrowing against Jevic's own assets. Shortly after the buyout, Jevic refinanced the acquisition debt with an $85 million loan from a consortium of lenders led by the CIT Group, secured by a lien on all of Jevic's assets. JA22.

Jevic soon defaulted on the loan. JA22. By the end of 2007, CIT had obtained a guarantee from Sun for $2 million of Jevic's debt and had entered into a forbearance agreement with Jevic. Pet. App. 2a. But Jevic remained in default when the forbearance agreement expired in May 2008. *Id.*; JA23. On May 19, 2008, Jevic terminated petitioners and similarly situated employees without notice. It filed a Chapter 11 petition the next day. Pet. App. 2a-3a.

2. Petitioners are representatives of a certified class of nearly 1,800 truck drivers and other employees whom Jevic fired without warning immediately before entering bankruptcy. Petitioners sued Jevic and Sun for violations of the Worker Adjustment and Retraining Notification (WARN) Act, 29 U.S.C. §§2101-2109, and an analogous New Jersey law, N.J. Stat. Ann. §§34:21-1 to -7, which require employers to provide advance notice of such a termination. CAJA1087-1099 (complaint), 1137-1138 (class certification).

Petitioners prevailed on their state-law claims against Jevic but not on their claims against Sun. *In re Jevic Holding Corp.*, 496 B.R. 151, 165 (Bankr. D. Del. 2013); *In re Jevic Holding Corp.*, 492 B.R. 416, 433 (Bankr. D. Del. 2013), *aff'd*, 526 B.R. 547 (D. Del. 2014), *aff'd*, 2016 WL 4011149 (3d Cir. July 27, 2016). For reasons described below, petitioners "never got the chance to present a damages case in the Bankruptcy Court, but they estimate their claim to have been worth

$12,400,000, of which $8,300,000 was a priority wage claim under" §507(a)(4). Pet. App. 6a.

3. Failed leveraged buyouts such as the one here are commonly challenged in bankruptcy court as fraudulent transfers. Generally, such suits allege that assets that otherwise would have been available to satisfy unsecured creditors' claims were fully encumbered by liens granted to finance the buyout of the debtor's old equity-holders and that the debtor did not receive reasonably equivalent value in return. *See* §§544(b), 548(a). Fraudulent transfer suits are assets of the bankruptcy estate, as are any funds recovered through such a suit; they are typically prosecuted by a trustee or debtor-in-possession. A debtor-in-possession, however, may not want to bring a fraudulent transfer suit arising from a transaction in which the debtor's management participated. When a debtor-in-possession declines to bring an estate cause of action, an official creditors' committee may seek leave to bring the suit on the estate's behalf. *See generally Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp.* v. *Chinery*, 330 F.3d 548 (3d Cir. 2003) (en banc).

In this case, an official committee of Jevic's unsecured creditors was authorized to litigate fraudulent transfer claims on behalf of Jevic's bankruptcy estate. JA56-57; CAJA342. The committee sued CIT and Sun, asserting that the leveraged buyout fraudulently transferred Jevic's value to them and left Jevic unable to pay its other creditors. The committee alleged that Sun, with CIT's active assistance, "acquired Jevic with virtually none of its own money" and "leverag[ed] all of [Jevic's] assets to the maximum extent possible," based on "ever more optimistic and aggressive" financial projections. JA54, 58, 66; *see also* JA70-73. Sun itself

"contribut[ed] only $1 million in equity, most of which it got back in 'fees.'" JA54-55. As a result, the suit alleged, Jevic's ultimate failure "was the foreseeable end of a reckless course of action in which Sun and CIT bore no risk but all other constituents did." JA80.

Based on those allegations, the committee asserted fraudulent transfer claims under both §548 and §544(b) of the Bankruptcy Code, seeking to avoid the liens that Sun and CIT asserted on Jevic's assets and to recover other assets transferred in connection with the leveraged buyout. JA82-98, 102-131. Under §548, a debtor-in-possession can unwind certain transfers of property that did not give the debtor reasonably equivalent value in return or that were undertaken to hinder, delay, or defraud creditors. Under §544(b), the debtor-in-possession can avoid any fraudulent transfer that would be avoidable by an unsecured creditor under state law—which gives individual creditors the ability to unwind fraudulent transfers in similar circumstances outside bankruptcy.

In September 2011, the bankruptcy court denied a motion to dismiss, holding that the committee had stated claims for fraudulent transfer, as well as other causes of action. JA36-47. The court dismissed certain other claims without prejudice (JA51-52), and the committee responded in October 2011 by filing an amended complaint (JA13). Had the committee prevailed, it would have been able to avoid all of CIT's and Sun's liens on Jevic's assets and could have recovered for the estate the value of the property Jevic transferred to CIT and Sun to finance the buyout—potentially more than $100 million. JA54-56.

B. The Settlement And Structured Dismissal

In June 2012, Jevic, Sun, CIT, and the committee of unsecured creditors filed a joint motion "pursuant to sections 105(a), 349 and 1112(b)" of the Code and "Rule 9019(a) of the Federal Rules of Bankruptcy," seeking approval of a settlement and structured dismissal that would settle the estate's claims against Sun and CIT, distribute the settlement proceeds, and dismiss the bankruptcy case. JA159.

Under the terms of the proposed order, the estate would dismiss its lawsuit and release all fraudulent transfer claims against Sun and CIT, including the state-law fraudulent transfer claims that Jevic's creditors could otherwise bring outside bankruptcy. JA162-163. In exchange, CIT would pay $2 million to Jevic to satisfy various administrative priority claims, including the committee's attorneys' fees. JA163-165, 185-186. Sun would assign a lien it claimed to hold on Jevic's remaining $1.7 million in cash to a trust to pay certain other priority claims, including tax claims, and then to pay general unsecured claims on a pro rata basis. JA163, 166-167, 192. The Chapter 11 case would then be dismissed. JA167-168.

The proposed structured dismissal deliberately skipped over petitioners in the distribution of estate assets. It is undisputed that petitioners had priority wage claims against the estate. *Supra* pp.11-12. Yet petitioners were to receive nothing on account of those claims, even though lower-priority general unsecured creditors would be paid. Sun apparently insisted on that arrangement because petitioners were still suing Sun for violating the WARN Act, and Sun refused to

provide petitioners any payments that could be used to fund that litigation. Pet. App. 6a n.4.[3]

Both petitioners and the U.S. Trustee objected to the settlement and structured dismissal on the ground that it violated the §507 priority scheme. Pet. App. 7a. As the U.S. Trustee explained, the fraudulent transfer action had been brought by the committee *on behalf of the estate*; the settlement proceeds accordingly "must be for the benefit of the estate" and subject to the Code's priority scheme governing distribution of estate property. CAJA530; *see* §541(a)(3), (6) (interests recovered through avoided transfers and proceeds of estate property are themselves estate property).

The bankruptcy court nevertheless approved the settlement and structured dismissal. Pet. App. 45a-52a. The court "acknowledge[d] that the proposed distributions are not in accordance with the absolute priority rule." *Id.* 58a. But in the court's view, the Code's priority rules were inapplicable "because this is not a plan, and there is no prospect here of a confirmable plan." *Id.* The court was also swayed by what it perceived as the "dire circumstances" of the case. *Id.* 57a. Jevic's only remaining cash was subject to the disputed liens held by CIT and Sun—leaving, in the court's opinion, insufficient resources to prosecute the fraudulent

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[3] Notably, the original proposed distribution also would have skipped over claims held by prepetition tax creditors—entitled to priority under §507(a)(8)—on the basis that there were "no available assets" to pay those claims. JA164. After those creditors objected, the settlement was revised to include partial payment of various prepetition tax claims among the distributions to be made from the settlement trust. JA197-204.

transfer action against Sun and CIT "creditably" or to confirm a Chapter 11 plan. *Id.* 56a.[4]

The bankruptcy court considered but rejected several alternatives to the structured dismissal. It acknowledged that the case could be converted to Chapter 7, where the estate would be liquidated according to the Code's priority scheme. However, the court accepted Sun's assertion that Sun "would not do this [settlement] in a Chapter 7" case, and that the estate would have no unencumbered assets for a Chapter 7 trustee to use to pursue litigation. Pet. App. 58a. The court also noted that counsel might be retained to litigate the fraudulent transfer suit on a contingency basis, but it asserted that "any lawyer" who took the case on contingency "should have his head examined"—notwithstanding the fact that the suit survived a motion to dismiss and Sun and CIT paid $3.7 million to settle it. *Id.* 60a-61a. The court therefore concluded that it could approve the structured dismissal's settlement and priority-skipping distribution pursuant to its authority under Federal Rule of Bankruptcy Procedure 9019 to "approve a compromise or settlement." *See id.* 56a, 61a.

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[4] The bankruptcy court also reasoned that because the priority-skipping distribution would be made from the estate's $1.7 million in remaining cash on which Sun supposedly held a lien, Sun could "dispose of its collateral as it wishes." Pet. App. 58a; *see also* JA192. That rationale is mistaken, and respondents did not defend it in the court of appeals or in their brief in opposition. Even if Sun held a lien on the cash, it relinquished that lien to settle *the estate's* avoidance action against it, and the proceeds of a settlement of an estate cause of action are estate property, §541(a)(6). Thus, earmarking those proceeds for general unsecured creditors was a disposition of estate assets, not of Sun's property. As discussed below (at 18), the Third Circuit resolved the case on that premise.

If the court had enforced the Code's priority scheme, no general unsecured creditors could have received any distributions until petitioners' higher-priority wage claims were paid in full (absent petitioners' consent to different treatment). Alternatively, if the court had simply dismissed the case, without approving the estate's release of the state-law fraudulent transfer claims belonging to Jevic's creditors, petitioners—as creditors of Jevic—would have been free to pursue such actions against Sun and CIT.[5] Instead, they were left with no recovery, and no means of recovering anything, on their New Jersey WARN Act claims.

C. Appeal

The district court affirmed. Like the bankruptcy court, the district court acknowledged that the settlement "does not follow the absolute priority rule" but reasoned that the settlement need not do so because "it is not a reorganization plan." Pet. App. 42a.

A divided panel of the Third Circuit also affirmed. The majority began by acknowledging that "the Code does not expressly authorize structured dismissals,"

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[5] Most States, including New Jersey, recognize such a cause of action for creditors outside bankruptcy. N.J. Stat. Ann. §§25:2-20 to-34. In bankruptcy, however, as noted above (at 12), the estate has the right to bring such claims, and the estate's settlement and release of such claims precludes creditors from bringing them after bankruptcy. *See, e.g.*, *In re PWS Holding Corp.*, 303 F.3d 308, 314-315 (3d Cir. 2002). Thus, when the committee, acting for the estate, settled and released the state-law fraudulent transfer claims, it extinguished rights petitioners otherwise could have invoked after dismissal to look to Sun and CIT for satisfaction of Jevic's debts to petitioners. *See* JA186-191 (releases).

and that dismissal ordinarily results in a "hard reset" to the prepetition status quo. Pet. App. 13a, 14a. But, noting that the Code "authorizes the bankruptcy court to alter the effect of dismissal 'for cause,'" it reasoned that a structured dismissal is permissible if it is not "used to circumvent" the Code's procedures "govern[ing] plan confirmation and conversion to Chapter 7." *Id.* 14a (quoting §349(b)).

The majority was "troubled" by the structured dismissal's departure from priority, noting that "[s]ettlements that skip objecting creditors in distributing estate assets raise justifiable concerns about collusion among debtors, creditors, and their attorneys and other professionals." Pet. App. 20a, 22a. But it reasoned that the absolute priority rule codified in §1129(b)(2) applies by its terms to plans, and that no Code provision explicitly prohibits priority-skipping distributions of settlement proceeds made outside a plan. *Id.* 17a. As to that question, the majority recognized that two other courts of appeals had reached divergent results, and opted to follow what it perceived to be the more "flexible" approach of the Second Circuit. *Id.* 17a-19a (discussing *In re AWECO, Inc.*, 725 F.2d 293 (5th Cir. 1984), and *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007)). Thus, it held that settlements that "distribut[e] estate assets" but "deviate from the priority scheme" may be approved under Rule 9019 in "rare instances," if the bankruptcy court has "'specific and credible grounds to justify [the] deviation.'" *Id.* 12a, 21a (alteration in original). And the majority found such grounds here, endorsing the bankruptcy court's view that the settlement and structured dismissal were the "least bad alternative." *Id.* 21a-22a.

Judge Scirica dissented. In his view, "the bankruptcy court's order undermined the Code's essential

priority scheme" by "skip[ping] over an entire class of creditors" in distributing estate property. Pet. App. 23a, 29a-30a. While he left open the possibility that in "extraordinary circumstances" the Code might permit a settlement that deviates from the priority scheme, he found that the settlement and structured dismissal here were designed as "an impermissible end-run around the carefully designed routes by which a debtor may emerge from Chapter 11 proceedings." *Id.* 24a, 27a-28a. Judge Scirica also warned that, contrary to the majority's assertion, the circumstances here were not "*sui generis*" and that it is "not difficult to imagine another secured creditor who wants to avoid providing funds to priority unsecured creditors." *Id.* 31a.

SUMMARY OF ARGUMENT

I. The Bankruptcy Code does not permit a bankruptcy court to approve a "structured dismissal" of a Chapter 11 case that distributes the estate to creditors in violation of the Code's priority scheme. The Code provides three, and only three, ways to resolve a Chapter 11 case: through a confirmed Chapter 11 plan, which must comply with priority, absent consent; through conversion to Chapter 7, which must also comply with priority; or through dismissal, which returns the estate's assets to their prebankruptcy owners and restores creditors' rights to pursue the debtor and its assets to recover on their claims. Nothing in the Code authorizes the court to distribute the estate to creditors through a "structured dismissal" that violates the Code's basic priority scheme.

In approving the settlement and structured dismissal, the bankruptcy court relied on Federal Rule of Bankruptcy Procedure 9019, which gives courts the power to "approve a compromise or settlement" of es-

tate claims. But both Rule 9019 and the underlying statutory authority for settlement, the power to approve the use or sale of estate property under §363(b), govern the *liquidation* of estate assets. They do not govern distribution of the proceeds—let alone provide authority to distribute them in violation of the priority scheme. Likewise, the authority under §349(b) to order limited departures for "cause" from the rule that dismissal returns estate property to its prebankruptcy owner does not permit the court to distribute the estate in violation of Chapter 11's priority scheme. Nor does §105(a), which codifies bankruptcy courts' residual equitable powers and provides that they may enter orders "necessary or appropriate to carry out the provisions" of the Code, confer such authority. This Court has squarely rejected the proposition that the Code permits bankruptcy courts to depart from the priority scheme to achieve what they consider more "equitable" or more practical outcomes.

Basic principles of statutory construction—that statutes must be read as a whole, and that specific provisions control over general provisions—compel this conclusion. The Code provides specific, limited authorization to distribute estate assets in accordance with priority—the central organizing principle of bankruptcy—or to dismiss a case without distributing assets. It does not, through general provisions or interstitial "equitable" authority, grant the power to dismiss a case while distributing assets in violation of priority.

II. Upholding the court of appeals' contrary rule would threaten the judgments that Congress made in §507 to protect employees from the disproportionate harm they suffer when their employer files for bankruptcy and to encourage employees not to flee when a business is failing—an inducement that is severely un-

dercut if its application is uncertain. It would also invite the same dangers of collusion among senior and junior stakeholders to squeeze out disfavored intermediate creditors that first motivated this Court to develop the absolute priority rule, and later motivated Congress to codify that rule in the current Bankruptcy Code. The court of appeals was mistaken in suggesting that giving bankruptcy courts the "flexibility" to depart from that rule would facilitate settlement; rather, it would simply redistribute settlement proceeds away from the priority creditors whom Congress intended to protect. And the effects of such departures would not be limited to the "rare" case in which there was no better alternative—a circumstance that the debtor and favored creditors would have substantial incentive and ability to concoct. The threat of a priority-skipping distribution in a structured dismissal would profoundly undermine the bargaining position of all priority creditors in all Chapter 11 cases, as they would never be certain that their priority status is, in fact, absolute.

ARGUMENT

I. STRUCTURED DISMISSALS MUST RESPECT THE CODE'S PRIORITY SCHEME

The Code does not permit a bankruptcy court to approve a structured dismissal that distributes estate assets to creditors in violation of the priorities that would govern an analogous distribution under a confirmed Chapter 11 plan or upon conversion to Chapter 7 for liquidation. Chapter 11 specifies in "meticulous" and "detailed" fashion, *Law* v. *Siegel*, 134 S. Ct. 1188, 1196 (2014), the procedures and requirements for confirmation of a plan, including compliance with the priority scheme. If a plan cannot be confirmed, the Chapter 11 case can be converted to Chapter 7, where again the

Code makes clear that Congress's priority scheme must be respected. The same must be true when a Chapter 11 case is dismissed. Nothing in the Code allows select creditors to agree with the debtor to "structure" the dismissal to secure for themselves a distribution the Code forbids in a confirmed plan or liquidation.

Respondents argue that nothing in the Code in so many words requires compliance with the priority scheme when a bankruptcy court approves a settlement of estate litigation, or when the court dismisses a Chapter 11 case. Opp. 1, 16-23. That is irrelevant. The Code does not expressly require compliance with the priority scheme in its provisions authorizing dismissal or settlement because those provisions were never intended to authorize a plan-like distribution of estate assets to creditors, like the one approved here. By providing a detailed and comprehensive structure for the distribution of estate assets at the end of a bankruptcy case—one that requires, as an indispensable component, compliance with the priority scheme—Congress unmistakably forbade deviations from that structure under the guise of dismissals, settlements, or any other device respondents might invoke.

"Statutory construction," the Court has explained, "is a holistic endeavor," in which individual provisions must be understood in the context in which Congress placed them. *United Sav. Ass'n of Tex.* v. *Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988). An interpretation of a given provision is permissible only if it "produces a substantive effect that is compatible with the rest of the law." *Id.*; *see also, e.g.*, *Davis* v. *Michigan Dep't of Treasury*, 489 U.S. 803, 809 (1989) (rejecting "hypertechnical reading" that was "not inconsistent with the language of [the] provision examined in isolation," but that was contradicted by "context" and "the

overall statutory scheme"); *Kelly* v. *Robinson*, 479 U.S. 36, 43 (1986) ("[W]e must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its objects and policy." (internal quotation marks omitted)); *infra* pp.38-41. Reading into the Code's provisions for dismissal or settlement a power to achieve what would be unlawful in a plan or liquidation fails to honor that basic precept.

A. A Distribution Of The Debtor's Estate Under A Plan Or In Chapter 7 Must Comply With §507, And A Dismissal Must Reinstate Creditors' Prebankruptcy Property Rights

Chapter 11 provides only three ways for a debtor to exit bankruptcy: confirmation of a Chapter 11 plan of reorganization or liquidation; conversion to Chapter 7; or dismissal. Under either a Chapter 11 plan, absent consent, or Chapter 7, estate assets must be distributed in accordance with priority; under a dismissal, estate assets are not distributed to creditors at all, and the parties regain their prebankruptcy rights insofar as that is possible. Those carefully specified options for exiting bankruptcy, and the strict and reticulated priority scheme that accompanies them, foreclose a debtor from creating its own, different priority scheme and implementing it through a "structured dismissal."

1. The Chapter 11 plan

a. Chapter 11 contains an intricate set of rules governing the formulation and confirmation of a plan for distributing the estate's value to creditors. The Code sets out detailed provisions governing who may file a plan, including when the debtor has the exclusive right to do so, §1121; the contents of the plan itself, §§1122-1123; the disclosures required to ensure credi-

tors can make an informed judgment about the plan, §1125; procedures for creditors to vote on the plan, §1126; and the substantive requirements for confirmation of the plan, including the priority scheme, §1129. These provisions create a framework through which the debtor and its stakeholders may seek to negotiate a consensual plan for distribution of the debtor's value. And they clearly set out creditors' default entitlements, which form the substantive backdrop of those negotiations.

Chapter 11 is intended to "preserv[e] going concerns" that are worth more if reorganized or sold as operating businesses than if liquidated piecemeal and to "maximiz[e] [the] property available to satisfy creditors." *Bank of Am. Trust & Sav. Ass'n* v. *203 N. LaSalle St. P'ship*, 526 U.S. 434, 453 (1999). Accordingly, the Bankruptcy Code provides the debtor and its stakeholders substantial flexibility in designing the terms of a Chapter 11 plan. The plan may vest the estate in the debtor and give creditors new securities in the reorganized enterprise in satisfaction of their old interests. §1123(a)(5)(A), (J). It may provide for the sale of property of the estate and distribution of the proceeds among creditors. §1123(a)(5)(D), (b)(4). It may modify the terms of loans. §1123(a)(5)(E)-(H), (b)(5). It may provide that claims belonging to the estate—like the fraudulent transfer suit against CIT and Sun in this case—will be litigated after confirmation, or alternatively, for the "settlement or adjustment" of such claims and distribution of the proceeds. §1123(b)(3)(A). And the plan may allocate the value of the estate's assets among creditors in any way agreed upon by the parties, so long as all affected classes of creditors consent. §1129(a)(7)-(9).

But a plan cannot be confirmed over the objection of a class of creditors unless the plan complies with both the absolute priority rule and the §507 priority scheme. §1129(a)(1), (9), (b)(1)-(2). If the settlement and distribution of estate assets approved here had been embodied in a Chapter 11 plan, it is undisputed that the plan could not have been confirmed. The settlement of the estate's suit against CIT and Sun could have been provided for in a plan, §1123(b)(3)(A), but the settlement proceeds could not have been distributed to general unsecured creditors over petitioners' objection unless their higher-priority claims were paid in full on the effective date of the plan, §1129(a)(9), (b)(2)(B).

Because bankruptcy cases frequently involve competition among different constituencies for limited value, creditors or equity-holders will at times attempt to subvert the statutory priority structure in favor of some other scheme of distribution more favorable to them. *See* Roe & Tung, *Breaking Bankruptcy Priority*, 99 Va. L. Rev. 1235, 1246, 1279 (2013). But despite the considerable flexibility that Congress built into the Chapter 11 plan process, it made a clear judgment that priority must be respected in the distribution of the value of the estate, absent creditors' consent to different treatment. That is the case even where, as here, the court believes that departing from priority would be the "least bad alternative" and would better serve the interests of creditors. *See Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 206-207 (1988) (equitable considerations cannot justify a violation of the absolute priority rule in a Chapter 11 plan).

b. In a few instances, the Code authorizes the distribution of estate assets to a creditor during an ongoing case, rather than through a plan. For example, a bankruptcy court may authorize cash payments to a

prepetition secured creditor as "adequate protection" against diminution in the value of its collateral during the bankruptcy case. §361(1). The court may also authorize a debtor to assume an executory contract before confirmation of a plan, provided that the debtor promptly cures any default under the contract and compensates the counterparty, including paying any prepetition claim resulting from the default. §365(a)-(b), (d)(2). And a Chapter 11 debtor-in-possession may operate its business during the case and pay postpetition expenses incurred in the ordinary course of business during the bankruptcy case. §§363(c)(1), 1108.

Those provisions are narrow in scope and are designed to enable the debtor to continue operating as a going concern in bankruptcy, while compensating the affected parties. Moreover, unlike the distribution here, each provision is consistent with the Code's priority scheme. Secured creditors have priority in the proceeds of their collateral, §§725, 1129(b)(2)(A); claims arising under assumed contracts are administrative expenses entitled to priority, §§503(b), 507; and postbankruptcy claims incurred in the ordinary course of business to preserve the estate are likewise administrative expenses entitled to priority, §§364(a), 503(b), 507(a)(2). These limited provisions for distribution of assets outside a plan thus only underline the centrality of the Code's priority scheme to all bankruptcy cases, however resolved.

2. Conversion to Chapter 7

If a plan cannot be confirmed, the debtor may convert the case to Chapter 7, or the court may do so for cause. §1112(a), (b)(1). Upon conversion, the Chapter 7 trustee must "collect and reduce to money the property of the estate." §704(a)(1). That includes pursuing to

judgment, or negotiating a settlement of, any legal claims held by the estate. *See infra* pp.30-31.

Once the Chapter 7 trustee has accounted for all assets of the estate, the trustee distributes to secured creditors the value of any property encumbered by their security interest (up to the value of their secured claim). §725 (trustee "shall dispose of any property in which an entity other than the estate has an interest, such as a lien"). After secured creditors receive the proceeds of their collateral, the trustee distributes any remaining property of the estate "first, in payment of claims of the kind specified in, and in the order specified in" §507—*i.e.*, to priority unsecured creditors. §726(a)(1). Only if all such claims are paid in full may the trustee distribute any remaining assets to general unsecured creditors. §726(a)(2).

As in Chapter 11, Congress denied bankruptcy courts any authority in Chapter 7 to order *ad hoc* departures from the Code's priority scheme. The only exceptions to the priority "waterfall" described above are expressly set out and narrow in scope. Thus, §726(a) provides that a priority claim may receive less favorable treatment if it is subject to legal or equitable subordination under §510. And §726(b) provides that, when a case has been converted from Chapter 11 to Chapter 7, priority claims for the cost of administering the Chapter 7 estate are paid before priority claims for administrative expenses incurred in the preceding Chapter 11 case. No provision of the Code permits the trustee or the bankruptcy court to deviate from Chapter 7's prescribed hierarchy of payments simply to produce a result perceived as more equitable. Thus, it is undisputed that the distribution ordered in this case also could not have occurred in Chapter 7.

3. Dismissal

If a Chapter 11 plan cannot be confirmed and the case is not converted to Chapter 7, the last option for exiting Chapter 11 is dismissal of the bankruptcy case in its entirety. §1112(b). Dismissal is fundamentally different from either confirmation of a Chapter 11 plan or conversion to Chapter 7. It is a backward-looking rather than a forward-looking exit from bankruptcy. The "day of reckoning" on which all of the estate's value is tallied up and redistributed does not occur. *Cf.* Baird, *Elements of Bankruptcy* 59 (6th ed. 2014). Thus, dismissal does not involve any distribution of the estate to creditors. Instead, estate assets revert to their prior owners.

The Code provides that dismissal of a bankruptcy case ordinarily "revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case." §349(b)(3). The Code thus "contemplates that on dismissal a bankrupt is reinvested with the estate" property it possessed before bankruptcy, "subject to all encumbrances which existed prior to the bankruptcy." *In re Income Prop. Builders, Inc.*, 699 F.2d 963, 965 (9th Cir. 1982) (per curiam). In addition, any property that the estate has recovered from third parties pursuant to fraudulent transfer and preference actions is typically returned to the third party in question. §349(b)(1)(B). Creditors' claims against the debtor are not discharged, and creditors' rights to collect those claims from third parties under state fraudulent-transfer law are reinstated. Revesting under §349(b) therefore permits creditors to pursue their claims against both the debtor and third parties according to their nonbankruptcy rights.

As discussed below, a bankruptcy court has limited authority to depart from this revesting rule "for cause." "Cause" means "an acceptable reason," *In re Sadler*, 935 F.2d 918, 921 (7th Cir. 1991), such as protecting a third party who changed position irreversibly in reliance on the bankruptcy. "The basic purpose of [§349(b)] is to undo the bankruptcy case, as far as practicable, and to restore all property rights to the position in which they were found at the commencement of the case." H.R. Rep. No. 95-595, at 338 (1977). The "cause" exception allows the court to "make the appropriate orders to protect rights acquired in reliance on the bankruptcy case," *id.*, while otherwise restoring the parties as much as possible to the status quo ante.

* * *

In contrast to the three alternatives discussed above, what happened here is contemplated nowhere in the Bankruptcy Code. No provision of the Code permits nonconsensual deviations from the otherwise mandatory priority scheme simply because the value of the estate is being distributed through a structured dismissal. The priority scheme is the way the Bankruptcy Code implements its primary purpose—the equitable distribution of estate property to creditors. Its careful and detailed provisions preclude any inference that debtors can cooperate with junior creditors to create an exit from Chapter 11 that excludes senior creditors from the distributions to which they are entitled.

B. No Other Provision Of The Bankruptcy Code Or Rules Grants Authority For A Priority-Skipping Structured Dismissal

Neither the bankruptcy court's power to approve a settlement under Federal Rule of Bankruptcy Procedure 9019 or §363 of the Bankruptcy Code, nor its pow-

er to dismiss a Chapter 11 case under §1112(b) and §349(b) of the Code, provides the authority to circumvent the Bankruptcy Code's priority scheme through a structured dismissal.

1. Settlement

a. The lower courts relied primarily on Federal Rule of Bankruptcy Procedure 9019 as the authority for the settlement and priority-skipping structured dismissal here. Pet. App. 11a, 60a. Rule 9019(a) provides that "[o]n motion by the trustee [or debtor-in-possession] and after notice and a hearing, the court may approve a compromise or settlement." It confers no authority to distribute estate value in violation of priority. In the first place, Rule 9019 is merely a rule of procedure, and as such cannot provide any basis to depart from the statutory priority scheme that Congress has enacted. *See* 28 U.S.C. §2075 (authorizing promulgation of procedural rules that do not "abridge, enlarge, or modify any substantive right").

Nor does Rule 9019 purport to govern the distribution of estate value. It applies to the settlement of contested claims, not the distribution of settlement proceeds. That is consistent with the Bankruptcy Code's basic division between the process of marshaling the estate's assets and maximizing their value, on the one hand, and the priority scheme for distributing that value to creditors at the end of the case, on the other. *See, e.g.*, Jackson, *The Logic and Limits of Bankruptcy Law* 7-19 (1986).

When the estate's assets include an unliquidated cause of action, the value of that cause of action can be maximized through two alternative means: litigation or settlement. If the estate litigates and prevails, it will

obtain a judgment requiring the defendant to pay the estate a judicially determined sum. But whether the estate will win, and the size of any damages award, may be uncertain. Moreover, litigating the claim could require the estate to incur significant litigation expenses, which have priority over general unsecured claims, §§330, 503(b)(2), 507(a)(2), and could take months or even years, delaying the distribution of any ultimate recovery.

Accordingly, "[i]n administering reorganization proceeding in an economical and practical manner it will often be wise to arrange the settlement of claims." *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc.* v. *Anderson*, 390 U.S. 414, 424 (1968). When a bankruptcy court is asked to approve a settlement, it should make a "full and fair assessment of the wisdom of the proposed compromise," informed by "all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated," as well as "an educated estimate of the complexity, expense, and likely duration of such litigation" and "the possible difficulties of collecting on any judgment." *Id.*

If the settlement is approved, the value of the estate's claim will be fixed at the amount of the settlement, and the proceeds will become part of the bankruptcy estate. §541(a)(1), (3), (6). The distribution of those proceeds is then governed by the Code's priority scheme. Thus, while Rule 9019 sets out the procedure for a court to approve the compromise of a claim of uncertain value, it provides no basis to "compromise" the Code's specific priority scheme in the absence of priority creditors' consent. Nor can parties to a bankruptcy, merely by agreeing to contravene that scheme as part of a "settlement," give the Court the authority to do

what Congress otherwise specifically prohibited. *Cf. In re Zale Corp.*, 62 F.3d 746, 754-757, 759-766 (5th Cir. 1995) (holding that authority to approve settlement of estate's claims did not permit court to approve settlement term barring nondebtor third party's claim against defendant over which court lacked jurisdiction; "parties c[an] not accomplish through settlement what they c[an] not attain directly").[6]

The court of appeals majority here reasoned that "it would make sense for the Bankruptcy Code … to leave bankruptcy courts more flexibility" to authorize departures from the priority scheme when approving settlements outside a plan. Pet. App. 20a. But it failed to cite any provision of the Code permitting such a departure, and there is none.

b. Neither respondents nor the courts below identified or relied on the *statutory* authority for settling an estate cause of action, which Rule 9019, as a rule of procedure, cannot provide on its own. The relevant provision is §363 of the Bankruptcy Code, which grants the

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[6] In *TMT Trailer*, the Court held that a settlement approved as part of a reorganization plan must be "fair and equitable" to all creditors, a term of art incorporating "the absolute priority doctrine." 390 U.S. at 424, 441. The Fifth Circuit has interpreted that decision to require compliance with the priority scheme whenever a bankruptcy court approves a settlement that entails the distribution of estate assets to creditors, whether as part of or before the confirmation of a Chapter 11 plan. *In re AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir. 1984) (citing *TMT Trailer*, 390 U.S. at 424, 441). The rule adopted in *AWECO* is sound in the context of structured dismissals for the reasons discussed above. That said, the relevant consideration is not whether the bankruptcy court is approving a settlement, but rather whether it is distributing estate assets—such as the proceeds of settling an estate cause of action—to creditors in satisfaction of their claims.

debtor-in-possession limited authority to use, sell, or lease property of the estate. A cause of action belonging to the estate is estate property. §541(a). The settlement of an estate cause of action is thus, in substance, a sale of estate property and is subject to the requirements of §363. *See, e.g.*, *In re Moore*, 608 F.3d 253, 263-265 (5th Cir. 2010); *Northview Motors, Inc.* v. *Chrysler Motors Corp.*, 186 F.3d 346, 350-351 & n.4 (3d Cir. 1999); *In re Martin*, 91 F.3d 389, 394-395 & n.2 (3d Cir. 1996). Like Rule 9019, §363 provides no authority to contravene the priority scheme.

Section 363 permits a Chapter 11 debtor-in-possession to use and sell estate property in the ordinary course of business without court approval, §§363(c)(1), 1107(a), 1108, but requires "notice and a hearing" before the debtor may "use, sell, or lease" estate property outside the ordinary course of business, §363(b)(1); *In re Roth Am., Inc.*, 975 F.2d 949, 952 (3d Cir. 1992). While Chapter 11 contemplates that disposition of significant estate assets will occur under a plan, §363(b) authorizes the debtor to dispose of such assets before a plan is confirmed where doing so will maximize the value realized from those assets. *See In re Lionel Corp.*, 722 F.2d 1063, 1069-1071 (2d Cir. 1983) (§363(b) authorizes preconfirmation sales where a "good business opportunity" may be lost unless "parties could act quickly"); *In re Chrysler LLC*, 405 B.R. 84, 96 (Bankr. S.D.N.Y. 2009) (authorizing preconfirmation sale "to preserve … the going concern value of the [debtor's] business and to maximize the value of the Debtors' estates" where debtor lacked funding to continue operations); *In re General Motors Corp.*, 407 B.R. 463, 474, 491-492 (Bankr. S.D.N.Y. 2009) (same), *aff'd on other grounds*, 428 B.R. 43 (S.D.N.Y. 2010).

While §363(b) authorizes the debtor, through sale or settlement, to reduce the assets of the bankruptcy estate to cash value, it says nothing about how the proceeds are to be distributed among creditors. The Bankruptcy Code's provisions governing priority, by contrast, establish a comprehensive, detailed scheme that specifically addresses how the estate is to be distributed among creditors. Whatever authority §363 may give a bankruptcy court to approve settlements outside a plan, it does not and cannot confer the authority to distribute the estate in contravention of that scheme. *See, e.g.*, *In re Braniff Airways, Inc.*, 700 F.2d 935, 939-940 (5th Cir. 1983) (§363(b) does not authorize a sale and settlement dictating distribution of proceeds contrary to the Code's absolute-priority rule); *In re Cajun Elec. Power Coop.*, 119 F.3d 349, 354 (5th Cir. 1997) (§363(b) "does not authorize the trustee to enter a settlement" that "'short circuit[s] the requirements of Chapter 11 for confirmation of a reorganization plan'"); *In re Continental Air Lines, Inc.*, 780 F.2d 1223, 1224, 1226-1228 (5th Cir. 1986) (§363(b) does not permit "an end run around the protection granted creditors in Chapter 11"); *Lionel*, 722 F.2d at 1069-1071 (§363(b) does not "grant[] the bankruptcy judge *carte blanche*" to "swallow[] up Chapter 11's safeguards"); *In re Westpoint Stevens, Inc.*, 333 B.R. 30, 50-54 (S.D.N.Y. 2005) (§363 did not authorize distribution of sale proceeds to junior creditors, over objection of senior secured creditors, contrary to Chapter 11's absolute priority rule), *aff'd in part & rev'd in part on other grounds*, 600 F.3d 231 (2d Cir. 2010).

2. Dismissal

Nor did the bankruptcy court's authority to dismiss a Chapter 11 case give it the power to distribute the estate in violation of the Code's priority scheme.

If a Chapter 11 debtor cannot confirm a plan, the court may convert the case to Chapter 7 or dismiss it. §1112(b). As discussed above (at 28-29), §349 provides that dismissal of a Chapter 11 case revests estate assets in the entities that owned those assets before the bankruptcy, returning the debtor and its creditors to the prebankruptcy status quo. §349(b).

A bankruptcy court may depart from §349's revesting rule only for "cause." §349(b). For instance, a bankruptcy court might choose, in order to protect creditors' interests, not to unwind a fraudulent-transfer or preference recovery by the estate. *Sadler*, 935 F.3d at 921. Or it might not reinstate a debtor's cause of action against a defendant who, in reliance on a release of that claim in the debtor's plan, gave up a lien on cash that was subsequently dispersed in the bankruptcy. *See Wiese* v. *Community Bank of Cent. Wis.*, 552 F.3d 584, 590 (7th Cir. 2009). But "'[c]ause' under §349(b) means an acceptable reason. Desire to make an end run around a statute is not an adequate reason." *Sadler*, 935 F.3d at 921.

Sadler involved family farmers who filed for Chapter 13 bankruptcy before the enactment of Chapter 12, which is specifically designed for family farms. In the Chapter 13 case, the debtors avoided a bank lien on their property through a preference action. After Chapter 12 was enacted, the debtors wanted to obtain its benefits, but the statute prohibited converting a Chapter 13 case pending on the date of enactment to a Chapter 12 case. The lower courts nonetheless permit-

ted the debtors to achieve the same result by dismissing their Chapter 13 case and filing a new Chapter 12 case. Under §349(b), dismissal of the Chapter 13 case would unwind the avoidance of the bank's lien, and the lien could not have been avoided in the new Chapter 12 case. But the district court reasoned that "the benefits of conversion to Chapter 12, coupled with the desire to avoid a windfall for the Bank, were 'cause' to specify that the dismissal did not reinstate the Bank's lien." *Sadler*, 935 F.3d at 920. The Seventh Circuit reversed, explaining that the debtors could not achieve the equivalent of conversion through a dismissal whose effects had been modified for "cause." "It is not part of the judicial office to seek out creative ways to defeat statutes. Although the [debtors] contend that equities cut in their favor, there is no equitable claim to achieve what Congress forbade." *Id.* at 921.

So too here. By authorizing limited departures from a "hard reset" of creditors' prebankruptcy rights upon dismissal (Pet. App. 14a), Congress did not grant bankruptcy courts the authority to distribute the estate's remaining assets to prepetition creditors in a way that would be flatly unlawful under any Chapter 11 plan that could be proposed.

The harm of allowing §349(b) to become a means of distributing estate assets, without complying with the Code's priority scheme, is well illustrated by this case. Had the Jevic bankruptcy case simply been dismissed, the estate's remaining assets would have revested in their prepetition owners, thereby restoring the estate's cash to Jevic and the state-law fraudulent-transfer claims to Jevic's creditors, who would have retained their state-law rights. Petitioners could have then pursued Sun and CIT under state fraudulent-transfer law for satisfaction of Jevic's unpaid debts to petitioners.

Supra p.17 & n.5. Instead, Sun and CIT were able to obtain a release of liability from the estate within the bankruptcy case, extinguishing petitioners' state-law remedies, in exchange for a distribution of estate property that deliberately skipped over petitioners. Section 349 cannot be read to permit such an evasion of the priority scheme.[7]

C. The Bankruptcy Code's Intricate Priority Scheme And Limited Options For Exiting Chapter 11 Foreclose A Priority-Skipping Structured Dismissal

Ordinary principles of statutory interpretation and this Court's precedent reinforce the common-sense conclusion that the general provisions granting authority to approve settlements and dismiss cases cannot override the specific priority scheme that applies to every Chapter 7 case and every Chapter 11 plan. Nor

[7] The bankruptcy court also lacked authority to approve the priority-skipping structured dismissal under its alternative rationale that secured creditors may dispose of their collateral as they wish. As an initial matter, respondents abandoned this argument on appeal, *see, e.g.*, Resp. C.A. Br. 15-17, and the court of appeals did not address it, resolving the case instead on the premise that the funds at issue were unencumbered estate assets. In any event, as noted, Sun relinquished its interest in the estate's remaining cash to settle the estate's action to avoid its liens and recover other transfers (*supra* n.4), and the settlement proceeds were accordingly estate property subject to the priority scheme—not Sun's property, §541(a)(3), (6). This case therefore does not present the question whether secured creditors may "gift" property to which they would otherwise be entitled to junior creditors while skipping an intermediate class of creditors. *See* American Bankruptcy Institute Commission To Study the Reform of Chapter 11, *2012-2014 Final Report and Recommendations* 237-238 (2014) (discussing division of authority over such "gifting" cases).

can any residual equitable authority the bankruptcy court might have provide a basis for rewriting the priority scheme Congress enacted.

1. The Bankruptcy Code's specific provisions governing distribution of estate assets trump general provisions permitting settlement and dismissal

"[I]t is a commonplace of statutory construction that the specific governs the general." *Morales* v. *Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992); *accord Morton* v. *Mancari*, 417 U.S. 535, 550-551 (1974); *D. Ginsberg & Sons, Inc.* v. *Popkin*, 285 U.S. 204, 206-209 (1932). "'[G]eneral language of a statutory provision, although broad enough to include it, will not be held to apply to a matter specifically dealt with in another part of the same enactment.'" *RadLAX Gateway Hotel, LLC* v. *Amalgamated Bank*, 132 S. Ct. 2065, 2071 (2012); *see, e.g.*, *Hinck* v. *United States*, 550 U.S. 501, 506-507 (2007) (holding Tax Court jurisdiction exclusive, "despite Congress's failure explicitly" to say so, under "well-established principle" that "a precisely drawn, detailed statute pre-empts more general remedies" (internal quotation marks omitted)); *United States* v. *Fausto*, 484 U.S. 439, 453-455 (1988) (holding that Congress's decision in the Civil Service Reform Act to provide judicial review of adverse personnel actions only for certain federal employees impliedly forbade other employees from seeking review under more general remedies predating CSRA).

Relatedly, as this Court has explained, "[s]tatutory construction … is a holistic endeavor," and statutory provisions should be construed in a way that "produces a substantive effect that is compatible with the rest of the law." *Timbers*, 484 U.S. at 371; *see also King* v.

Burwell, 135 S. Ct. 2480, 2489 (2015) ("[W]e must read the words [of a statute] 'in their context and with a view to their place in the overall statutory scheme.'"); *Kelly*, 479 U.S. at 43 ("In expounding [the Bankruptcy Code], we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." (internal quotation marks omitted)).

In *Timbers*, this Court applied these principles to reject a construction of the Bankruptcy Code that would read a general administrative provision to authorize a result inconsistent with a specific provision elsewhere in the Code. The question in *Timbers* was whether the Bankruptcy Code's provisions for adequate protection for secured creditors required that undersecured creditors be paid postpetition interest to account for the time value of money. 484 U.S. at 369. Although §362(d)(1)'s broad language protecting a secured creditor's "interest" in collateral "could reasonably … mean[]" that undersecured creditors must receive postpetition interest, this Court rejected that reading because it would "contradict[] the carefully drawn disposition of §506(b)," which authorizes postpetition interest only for oversecured creditors. *Id.* at 371, 373.

Likewise, in *Hartford Underwriters Insurance Co.* v. *Union Planters Bank, N.A.*, this Court construed §506(c) of the Bankruptcy Code, which provides that "[t]he trustee may recover" from a secured creditor certain costs incurred to preserve the creditor's collateral. 530 U.S. 1, 5 (2000). Petitioner, an unsecured creditor, claimed that it was entitled to such a recovery, arguing that the statute said only "that the trustee may seek recovery …, not that others may not." *Id.* at 6. This Court had "little difficulty" rejecting that position,

noting that "[s]everal contextual features" of the Code demonstrated that it is a "proper inference that the trustee is the only party empowered to invoke the provision." *Id.* Here too, respondents contend that the Bankruptcy Code does not expressly forbid priority-violating distributions outside a plan. And here too, the provisions of the Code give rise to a clear negative inference prohibiting such distributions. Chapter 11 does not specify any means of distributing the estate's value at the end of the case except a plan, and a plan must respect priority; the common-sense conclusion is that Chapter 11 does not permit what was done here.

More recently, in *RadLAX*, this Court addressed a closely analogous question. There, the debtors argued that the Code provides two options for selling a creditor's collateral under a plan—in a sale meeting specified conditions or on other terms giving the creditor the "indubitable equivalent" of its secured claim—and that the Code expressly grants the creditor the right to credit-bid only under the first option. They reasoned that creditors may thus be forbidden to credit-bid under the second option as long as the sale satisfies the "'indubitable equivalent'" standard. 132 S. Ct. at 2070; *see* §1129(b)(2)(A)(ii)-(iii). This Court rejected that reading as "hyperliteral and contrary to common sense," holding that where "a general authorization and a more limited, specific authorization exist side-by-side," the "terms of the specific authorization must be complied with." *RadLAX*, 132 S. Ct. at 2070, 2071. "That is particularly true where, as in §1129(b)(2)(A), 'Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions.'" *Id.* at 2071.

Respondents here similarly argue that Chapter 11 requires compliance with priority when the estate's

value is distributed under a plan but not when the bankruptcy court is using its power to approve settlements or dismiss a case. That argument fails here just as it did in *RadLAX*. The Bankruptcy Code establishes a comprehensive scheme that targets a specific problem—a debtor whose assets may prove insufficient to pay all creditors in full—and responds with a specific solution—a detailed regime for distributing the debtor's value among competing stakeholders. Indeed, that is bankruptcy's core function. The Bankruptcy Code largely leaves the substance of creditors' claims to nonbankruptcy law; its primary object is to apportion the debtor's limited value in satisfaction of those claims. §502(b)(1); *Butner* v. *United States*, 440 U.S. 48, 54-57 (1979); Jackson 7-19; Baird 57-75.

"Congress … does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes." *Whitman* v. *American Trucking Ass'ns*, 531 U.S. 457, 468 (2001). The Code cannot sensibly be read to give bankruptcy courts the authority to override the priority scheme Congress mandated through ancillary provisions governing the settlement of disputed claims or dismissal of failed Chapter 11 cases.

2. The bankruptcy court's "equitable" powers do not authorize departures from the priority scheme

The bankruptcy court believed that its departure from the Code's priority scheme would better serve "the paramount interest of the creditors." Pet. App.

61a.[8] Likewise, the Third Circuit defended the bankruptcy court's decision on the ground that, while "unsatisfying," it was the "least bad alternative." *Id.* 21a.

But this Court has repeatedly held that equitable considerations—a bankruptcy judge's own personal evaluation of the best or "least bad" result in a given case—cannot justify departures from the statutory priority scheme. In *Ahlers*, the Court reversed a decision of the Eighth Circuit approving a plan permitting equity owners of a farming business to retain property even though unsecured claims were not paid in full. 485 U.S. at 200-201, 207. The Court considered and rejected arguments that the equitable power of the bankruptcy court justified this "exception" to absolute priority. *Id.* at 206-207. "The Court of Appeals may well have believed that petitioners or other unsecured creditors would be better off if respondents' reorganization plan was confirmed. But that determination is for the creditors to make in the manner specified by the Code." *Id.* at 207. "[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Id.* at 206.

Similarly, in *United States* v. *Noland*, the Court rejected a bankruptcy court's effort to "equitably subordinate" claims with statutory priority to lower-priority claims. 517 U.S. 535, 536, 540 (1996). In *Noland*, the United States had claims for taxes, interest, and penal-

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[8] The bankruptcy court's order (Pet. App. 45a-46a) invoked §105(a), which codifies the bankruptcy court's residual equitable authority to enter orders "necessary or appropriate to carry out the provisions" of the Bankruptcy Code. Respondents have since disclaimed any reliance on §105(a). Opp. 18 n.3.

ties entitled to priority under §503 and §507. *Id.* at 537. While acknowledging the claims' priority status, the bankruptcy court nonetheless ruled that the claim for tax penalties should be subject to equitable subordination under §510(c) of the Code based on the "relative equities" of the matter. *Id.* In its view, affirmed by the Sixth Circuit, estate assets were better used for "'compensating actual loss claims,'" rather than providing additional recovery for the IRS. *Id.* This Court soundly rejected that effort to second-guess Congress's judgment, holding that courts cannot rewrite the Code's priority scheme to produce outcomes that they believe to be fairer. *Id.* at 540-541, 543.

Most recently, in *Law*, this Court rejected an attempt to use §105(a) in a way that contravened provisions of the Code, explaining that §105(a) "confers authority to 'carry out' the provisions of the Code, but it is quite impossible to do that by taking action that the Code prohibits." 134 S. Ct. at 1194. In *Law*, the Court held that a bankruptcy court could not sanction a debtor for egregious misconduct by denying him the benefit of the homestead exemption granted by the Code. *Id.* at 1198. Because the Code already contained a "mind-numbingly detailed[] enumeration" of the circumstances in which exemptions are available, this Court concluded, the bankruptcy court could not, based on its own assessment of the equities, vary from those provisions. *Id.* at 1196. "That is simply an application of the axiom that a statute's general permission to take actions of a certain type must yield to a specific prohibition found elsewhere." *Id.* at 1194.

The same is true here. Congress has determined that the value of a bankruptcy estate should be distributed in accordance with the priorities it has specified, and the bankruptcy court lacked any equitable authori-

ty to contravene that priority scheme. Contrary to the court of appeals' characterization, there is nothing "nihilistic" about that conclusion. Pet. App. 23a. Congress considered the matter and, notwithstanding the significant flexibility Chapter 11 provides, it chose not to give bankruptcy courts the discretion to alter priority without the consent of the affected class of creditors. In choosing to specify exactly how estate assets must be distributed, rather than grant bankruptcy courts leeway to vary that distribution to "serv[e] the interests of the estate and its creditors" (*id.*), Congress chose a clear default rule, rather than a murky standard, to govern the parties' dealings in bankruptcy. That choice must be respected.

II. A CONTRARY RULE WOULD THREATEN THE JUDGMENTS CONGRESS MADE IN §507 AND WOULD INVITE COLLUSION TO SQUEEZE OUT DISFAVORED CREDITORS

Allowing debtors and select creditors to avoid the priority scheme by structured dismissal not only violates the text and overall structure of Chapter 11, but is also inconsistent with the history and purpose of the priority scheme. The rule of absolute priority took hold in this Court's decisions and was later enshrined in the Code to prevent precisely the same dynamic that occurred here: collaboration between senior creditors and junior creditors or equity-holders to squeeze out disfavored intermediate creditors. Congress also made a principled judgment to prefer some unsecured claims over others in the priority scheme. The decision below wrongly licenses private parties and bankruptcy courts to disregard those policy choices.

Against those significant costs, the rule adopted below has virtually no countervailing benefits. Allowing priority-skipping settlements and structured dismissals

will not facilitate settlement, as the panel majority claimed, but will merely redistribute the proceeds of settlement away from the priority creditors whom Congress sought to protect. Nor will such an outcome be confined to the occasional "rare" case in which there are no better alternatives (a criterion not even met in this very case). The threat of a priority-skipping distribution in a structured dismissal over the objection of an impaired class of priority creditors will profoundly alter Chapter 11 plan negotiations in a manner Congress did not anticipate and the Code does not condone.

A. The Priority Scheme Plays An Essential Role In Chapter 11

1. Strict adherence to the priority scheme when distributing estate assets to creditors is critical to effectuate and protect the choices Congress made in that scheme. The decision to prefer an entire category of unsecured claims over others is quintessentially "a legislative type of decision." *Noland*, 517 U.S. at 541. Allowing bankruptcy courts to approve structured dismissals that violate the priority scheme will undermine those legislative decisions and upset the policy commitments embedded in §507.

The claims at issue here are illustrative. Congress has long given priority to claims by employees of the debtor for unpaid wages, salaries, or commissions, §507(a)(4), and unpaid contributions to an employee benefit plan, §507(a)(5). Indeed, a "preferred position" for claims for unpaid "wages … due to workmen" has been a feature of bankruptcy law since 1841. *United States* v. *Embassy Rest., Inc.*, 359 U.S. 29, 31 & n.4 (1959); *see also* Bankruptcy Act of July 1, 1898, ch. 541, §64(b)(4), 30 Stat. 544, 563 (priority for "wages due to workmen, clerks, or servants"). As Judge Hand ex-

plained, Congress extended that special treatment in part because employees, unlike other creditors, often cannot "be expected to know anything of the credit of their employer" and instead "accept a job as it comes." *In re Lawsam Elec. Co.*, 300 F. 736, 736 (S.D.N.Y. 1924). Employees also likely have no other sources of income and no means of demanding security from their employer when extending credit, so they and their families are especially harmed by an employer's failure. Kauper, *Insolvency Statutes Preferring Wages Due Employees*, 30 Mich. L. Rev. 504, 507-508 (1932). And, finally, the wage priority encourages employees not to jump ship when a business is failing—a prospect that could both hasten bankruptcy and make a successful reorganization more difficult, harming all creditors. *See supra* p.10.

Nothing in the Code suggests that Congress intended those protections to apply in Chapter 11 cases that result in a confirmed plan, but not in Chapter 11 cases that result in a structured dismissal—an outcome employees cannot predict in advance, when they must decide whether to join or stay with a financially distressed business.[9] If anything, a bankruptcy that ends in a structured dismissal is likely to leave employees

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[9] The same timing concern applies to other claims as well. For example, Congress gave superpriority to certain postpetition financing, §364(d), to encourage such lending as a means of preserving and maximizing the value of the estate. That incentive to extend credit will be substantially undercut if a lender must guess, in advance, whether its priority will actually be honored. The same is true for the priority given to postpetition administrative expenses, §§503(b), 507(a)(2), which encourages counterparties to continue doing business with the debtor during its reorganization efforts.

worse off than a successful reorganization, insofar as the debtor ceases to do business entirely, thus making a small measure of protection for the employees' prepetition unpaid wages even more important.

Allowing structured dismissals to evade §507 would also be inconsistent with the priority scheme's broader place in the architecture of the Code. *See supra* pp.23-29. In fact, in defending the settlement and dismissal that occurred below, even respondents recognized "the importance of the priority system," and they urged a rule under which "'compliance with the Code priorities *will usually be dispositive* of whether a proposed settlement is fair and equitable'" to all creditors. Opp. 19 (quoting Pet. App. 20a). If it were true, as respondents contend, that compliance with the priority scheme is not required for a settlement and structured dismissal because no provision of the Code says so expressly, it is hard to see why compliance would nevertheless "usually" be required. A far more compelling reading of the Code is that compliance is always required, in order to protect the categorical judgments Congress made.

2. Allowing priority-skipping distributions like the one that occurred here would also invite the same dangers of collusion that motivated the Court to develop and apply the concept of absolute priority. The doctrine originated in equity receivership cases, largely involving railroads, to protect junior creditors from the danger that senior creditors, corporate insiders, and stockholders—sometimes the same persons—would collude during reorganizations to benefit themselves while cutting junior creditors out of the process. *See, e.g., Louisville Trust Co.* v. *Louisville, New Albany & Chi. Ry.*, 174 U.S. 674, 684 (1899); *Northern Pac. Ry.* v. *Boyd*, 228 U.S. 482, 504-508 (1913); *see also* Baird 59-67. To forestall such collusion, the Court required "rigid

adherence" to the "'fixed principle'" that stockholders (having the lowest priority) could not receive any of the value of the reorganized enterprise over the objection of more senior creditors unless those creditors were paid in full. *Kansas City Terminal Ry.* v. *Central Union Trust Co. of N.Y.*, 271 U.S. 445, 454 (1926) (quoting *Boyd*, 228 U.S. at 507).

In *Case* v. *Los Angeles Lumber Products Co.*, the Court held that Congress codified the rule of absolute priority by amending the Bankruptcy Act of 1898 to require that any plan of reorganization be "fair and equitable" to creditors. 308 U.S. 106, 114-115 & n.6 (1939). The Court explained that "[t]he words 'fair and equitable' … are words of art," meaning a "rule of full or absolute priority." *Id.* at 115, 117; *accord Marine Harbor Props., Inc.* v. *Manufacturers Trust Co.*, 317 U.S. 78, 85 (1942). The modern Code, unlike the Bankruptcy Act, spells out in detail the requirement for compliance with absolute priority in meeting the "fair and equitable" standard, §1129(b)(2), but the underlying principle has remained unchanged. A "'dissenting class of [senior] creditors must be provided for in full before any junior class can receive or retain any property'" in a reorganization, absent consent to different treatment. *Ahlers*, 485 U.S. at 202.

As a result, absolute priority "has been the cornerstone of reorganization practice and theory" for over 75 years. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 123 (1991); *see* Roe & Tung, 99 Va. L. Rev. at 1236 ("Absolute priority is central to the structure of business reorganization and is, quite appropriately, bankruptcy's most important and famous rule."). It has remained so important in theory and practice because of the "danger inherent in any reorganization plan pro-

posed by a debtor, then and now, that the plan will simply turn out to be too good a deal for the debtor's owners," at the expense of disfavored creditors. *203 N. LaSalle*, 526 U.S. at 444 (citing H.R. Doc. No. 93-137, pt. I, at 255 (1973) (absolute priority rule developed to protect against "the ability of a few insiders, whether representatives of management or major creditors, to use the reorganization process to gain an unfair advantage")); *see also In re Hutch Holdings, Inc.*, 532 B.R. 866, 884 (Bankr. S.D. Ga. 2015) (Bankruptcy Code's enactment was driven in part by "'the need for greater transparency and dismantling of the 'bankruptcy ring' of perceived insiders among bankruptcy specialists and the courts'"); H.R. Rep. No. 95-595, at 92 (Congress was addressing concern that "the bankruptcy system operates more for the benefit of attorneys than for the benefit of creditors").

Precisely those same dangers are present for structured dismissals, as illustrated by this case. If senior creditors and general unsecured creditors can arrange to dismiss a Chapter 11 case and distribute the estate's remaining property in violation of the priority scheme, squeezing out disfavored intermediate priority creditors, they will have substantial incentives to do so in many cases. Here, the committee of general unsecured creditors was allowed to settle the estate's claims and to agree with the debtor and senior creditors to a distribution of estate assets that paid the committee's attorneys' fees and a portion of general unsecured creditors' claims, while skipping over petitioners' higher-priority claims. *Supra* pp.14-15. Sun and CIT received a full release of the estate's claims against them; the committee's lawyers and certain other administrative and priority claimants were paid; the committee arranged for general unsecured creditors to be paid; but

petitioners' priority claims were deliberately left unpaid, and petitioners were barred from pursuing fraudulent-transfer claims against Sun and CIT that might have given them a recovery. The Code's priority scheme is intended to prevent just this kind of outcome.

Even the court of appeals acknowledged the "justifiable concerns about collusion" raised by a priority-skipping distribution. Pet. App. 20a. The lesson of history, drawn from this Court's precedent, is that "rigid adherence" to the priority scheme is necessary to prevent such collusion. *Kansas City Terminal Ry.*, 271 U.S. at 454.

B. Compliance With The Priority Scheme Promotes Settlement

The court of appeals reasoned that bankruptcy courts need "more flexibility in approving settlements than in confirming plans" and therefore that they should be permitted to approve nonconsensual departures from the priority scheme to promote settlement. Pet. App. 20a. There is no basis for that view. To the contrary, in bankruptcy as elsewhere, clear and stable rules facilitate settlement by making the law more predictable to all parties in advance. *See, e.g.*, Landes & Posner, *Legal Precedent*, 19 J.L. & Econ. 249, 271 (1976) (noting that "the ratio of lawsuits to settlements is mainly a function of the amount of uncertainty, which leads to divergent estimates by the parties of the probable outcome"); *cf. Blue Cross & Blue Shield Ass'n* v. *American Express Co.*, 467 F.3d 634, 640 (7th Cir. 2006) ("In the long run, everyone gains from predictability (and from rules that reduce the expense of litigating about such transactions)."). Having such clear rules is particularly valuable in the "unruly" context of bankruptcy law. *RadLAX*, 132 S. Ct. at 2073. Uncertainty

as to whether priority will be respected would affect the terms and pricing of loans to many companies outside of bankruptcy; and once in bankruptcy, the additional litigation promoted by such uncertainty "takes money directly out of the pockets of creditors." *General Motors*, 407 B.R. at 504.

The court of appeals' concern for additional flexibility was thus misplaced. All settlements are negotiated against the backdrop of legal rules. There is no reason to believe that respecting those rules in bankruptcy will prevent parties from reaching consensual settlements. Disregarding absolute priority in some unspecified set of "rare" cases (Pet. App. 2a) will simply result in settlements that are more favorable to the settling parties at the expense of disfavored priority creditors.

This case is again illustrative. To the panel majority and the bankruptcy court, the settlement approved here was defensible because there was no "viable alternative," meaning no other possible settlement and no prospect of a confirmable plan. Pet. App. 22a. However, as Judge Scirica correctly perceived in dissent, the putative impossibility of alternative arrangements was "at least in part, a product of [respondents'] own making." *Id.* 25a. Sun, one of the defendants in the estate's fraudulent conveyance action, claimed it would not agree to any settlement of that action that provided funds to petitioners, who were separately suing Sun for violating the WARN Act (*id.* 6a n.4); but it is highly implausible that Sun would have paid *nothing* to achieve the benefits it obtained through the settlement if the bankruptcy court had required that priority be respected. Permitting courts to approve departures from priority allows settling parties to avoid complying with the priority scheme merely by making such self-serving statements. And even if such a settlement had

truly been impossible, the answer would not have been to disregard the Code's requirements. Rather, the Code already provides ready alternatives if a Chapter 11 plan cannot be confirmed: conversion to Chapter 7 for liquidation or dismissal of the case, with a return to the prepetition status quo. §1112(a)-(b); *supra* pp.26-29.

C. Allowing Priority-Skipping Structured Dismissals In "Rare" Cases Is Untenable

The court of appeals asserted that its decision should be read to permit a priority-skipping settlement and structured dismissal only in a "rare case" (Pet. App. 2a), but that putative limitation is untenable.

First, allowing priority-skipping structured dismissals in *any* Chapter 11 cases will profoundly undermine the bargaining position of priority creditors in *all* cases. The absolute priority rule and the associated hierarchy of priorities provide the backbone for Chapter 11 plan negotiations. *See* Blum & Kaplan, *The Absolute Priority Doctrine in Corporate Reorganizations*, 41 U. Chi. L. Rev. 651, 653 (1974) (absolute priority is "a way of structuring negotiations so that they are sufficiently disciplined to be held within permissible areas"). The certainty that a plan cannot be confirmed over the objection of an impaired class of creditors if any lower-priority claims are paid provides "the heart of the leverage" these creditors are given by the Code in negotiations. Warren, *A Theory of Absolute Priority*, 1991 Ann. Surv. Am. L. 9, 30. "All negotiations" take place around that leverage, and, "[t]o the extent that each party has the power under the Bankruptcy Code to force the other to yield, that power is reflected in the terms of any consensual plan." *Id.*

That framework explains why creditors in Chapter 11 are free to consent to less favorable treatment than the absolute priority rule might otherwise require. Congress envisioned Chapter 11 as a process in which interested parties, not courts, decide for themselves "how the value of the reorganizing company will be distributed," through consensual negotiations after full disclosure. H.R. Rep. No. 95-595, at 224. Particular creditors may well decide that a mutually beneficial plan that does not comply in all respects with absolute priority is preferable to other options. But the Code leaves that decision to the creditors.

Allowing priority-skipping structured dismissals will profoundly affect those negotiations, even if such departures from the priority scheme in fact remain rare. The background threat of such a distribution will hang over the parties' bargaining and will erode the leverage that Congress intended to provide in affording some unsecured claims priority over others. Priority creditors such as petitioners will never know whether their priority status is really absolute.

Second, as many commentators have already recognized, allowing priority-skipping structured dismissals in "rare" cases is an invitation to interested parties to try to *create* "rare" cases: "[O]nce the floodgates are opened, debtors and favored creditors can be expected to make every case that 'rare case.'" Rudzik, *A Priority Is A Priority Is A Priority—Except When It Isn't*, 34 Am. Bankr. Inst. J. 16, 17 (Sept. 2015).[10] And the

[10] *See also* Lipson & Walsh, ABA Business Bankruptcy Committee Newsletter, *In re Jevic Holding Corp.* 3 (May 21, 2015), http://apps.americanbar.org/buslaw/committees/CL160000pub/newsletter/201507/fa_3.pdf ("While [the Third Circuit's deci-

more willing judges appear to be to approve a priority-skipping structured dismissal as the best option among bad options, the "more likely that parties will find ways to orchestrate an environment in which it is the best option." Baird, *Bankruptcy's Quiet Revolution*, U. Chi. Coase-Sandor Inst. L. & Econ. Working Paper No. 755, at 13 (Apr. 2016). "The rationale for refusing to enforce such [settlement] agreements is the same as the rationale for outlawing the payment of ransom or putting in place a policy of never negotiating with terrorists." *Id.*

That is not mere speculation. Bankruptcy law is replete with examples of remedies initially approved only as "exceptional," but that ultimately become commonplace. The Third Circuit's own case law holds, for instance, that a nonconsensual release of the claims of a third party against a nondebtor entity is permitted only in "extraordinary cases," *In re Continental Airlines*, 203 F.3d 203, 212 (3d Cir. 2000), but such releases are now routinely included in large Chapter 11 plans of reorganization, *see* Silverstein, *Hiding in Plain View*, 23

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sion] purports to be narrow, it would seem to invite further litigation to test its boundaries."); Goffman et al., *Third Circuit Provides Road Map for Structured Dismissals* (May 28, 2015), https://www.skadden.com/sites/default/files/publications/Third_Circuit_Provides_Road_Map_for_Structured_Dismissals.pdf (similar); Swett, *Supreme Court to Review Priority-Skipping Settlement and Structured Dismissal of Chapter 11 Case* (Aug. 5, 2016), http://www.capdale.com/files/18529_Supreme_Court_to_review_priority-skipping_settlement_and_structured_dismissal_of_Chapter_11_case.pdf (*Jevic* "invites parties to devote their energies [to] 'gaming' bankruptcy cases without fully submitting either to Chapter 11 or Chapter 7, rather than negotiating or litigating within the prescribed framework").

Emory Bankr. Dev. J. 13, 18 (2006) (describing third-party releases as "increasingly common").

Third, bankruptcy judges will not be well positioned to judge whether a structured dismissal like this one is truly the option of last resort—whether there are, in the court of appeals' formulation, "'specific and credible grounds'" (Pet. App. 21a) to distinguish a given case from the mine run of failed Chapter 11 cases. "A mass of experience" in bankruptcy practice "reveals that courts have generally been prone to accept compromises in order to expedite termination of lengthy proceedings over complicated corporate financial matters," Blum & Kaplan, 41 U. Chi. L. Rev. at 664, and understandably so. The parties seeking approval of a structured dismissal have substantial control over how the circumstances are framed for the court, and many of the disfavored priority creditors who are likely to be squeezed out—employees, farmers, consumers, §507(a)(4)-(7)—are also likely to lack the means to contest that framing effectively. Nor should they be forced to do so, under the correct interpretation of the Code.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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AUGUST 2016

APPENDIX

11 U.S.C. § 103. Applicability of chapters

(a) Except as provided in section 1161 of this title, chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title, and this chapter, sections 307, 362(o), 555 through 557, and 559 through 562 apply in a case under chapter 15.

(b) Subchapters I and II of chapter 7 of this title apply only in a case under such chapter.

(c) Subchapter III of chapter 7 of this title applies only in a case under such chapter concerning a stockbroker.

(d) Subchapter IV of chapter 7 of this title applies only in a case under such chapter concerning a commodity broker.

(e) Scope of Application.—Subchapter V of chapter 7 of this title shall apply only in a case under such chapter concerning the liquidation of an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991.

(f) Except as provided in section 901 of this title, only chapters 1 and 9 of this title apply in a case under such chapter 9.

(g) Except as provided in section 901 of this title, subchapters I, II, and III of chapter 11 of this title apply only in a case under such chapter.

(h) Subchapter IV of chapter 11 of this title applies only in a case under such chapter concerning a railroad.

(i) Chapter 13 of this title applies only in a case under such chapter.

(j) Chapter 12 of this title applies only in a case under such chapter.

(k) Chapter 15 applies only in a case under such chapter, except that—

(1) sections 1505, 1513, and 1514 apply in all cases under this title; and

(2) section 1509 applies whether or not a case under this title is pending.

11 U.S.C. § 105. Power of court

(a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

(b) Notwithstanding subsection (a) of this section, a court may not appoint a receiver in a case under this title.

(c) The ability of any district judge or other officer or employee of a district court to exercise any of the authority or responsibilities conferred upon the court under this title shall be determined by reference to the provisions relating to such judge, officer, or employee set forth in title 28. This subsection shall not be interpreted to exclude bankruptcy judges and other officers or employees appointed pursuant to chapter 6 of title 28 from its operation.

(d) The court, on its own motion or on the request of a party in interest—

(1) shall hold such status conferences as are necessary to further the expeditious and economical resolution of the case; and

(2) unless inconsistent with another provision of this title or with applicable Federal Rules of Bankruptcy Procedure, may issue an order at any such conference prescribing such limitations and conditions as the court deems appropriate to ensure that the case is handled expeditiously and economically, including an order that—

(A) sets the date by which the trustee must assume or reject an executory contract or unexpired lease; or

(B) in a case under chapter 11 of this title—

(i) sets a date by which the debtor, or trustee if one has been appointed, shall file a disclosure statement and plan;

(ii) sets a date by which the debtor, or trustee if one has been appointed, shall solicit acceptances of a plan;

(iii) sets the date by which a party in interest other than a debtor may file a plan;

(iv) sets a date by which a proponent of a plan, other than the debtor, shall solicit acceptances of such plan;

(v) fixes the scope and format of the notice to be provided regarding the hearing on approval of the disclosure statement; or

(vi) provides that the hearing on approval of the disclosure statement may be combined with the hearing on confirmation of the plan.

11 U.S.C. § 349. Effect of dismissal

(a) Unless the court, for cause, orders otherwise, the dismissal of a case under this title does not bar the discharge, in a later case under this title, of debts that were dischargeable in the case dismissed; nor does the dismissal of a case under this title prejudice the debtor with regard to the filing of a subsequent petition under this title, except as provided in section 109(g) of this title.

(b) Unless the court, for cause, orders otherwise, a dismissal of a case other than under section 742 of this title—

(1) reinstates—

(A) any proceeding or custodianship superseded under section 543 of this title;

(B) any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or preserved under section 510(c)(2), 522(i)(2), or 551 of this title; and

(C) any lien voided under section 506(d) of this title;

(2) vacates any order, judgment, or transfer ordered, under section 522(i)(1), 542, 550, or 553 of this title; and

(3) revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title.

11 U.S.C. § 363. Use, sale, or lease of property

(a) In this section, "cash collateral" means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

(b) (1) The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless—

(A) such sale or such lease is consistent with such policy; or

(B) after appointment of a consumer privacy ombudsman in accordance with section 332, and after notice and a hearing, the court approves such sale or such lease—

(i) giving due consideration to the facts, circumstances, and conditions of such sale or such lease; and

(ii) finding that no showing was made that such sale or such lease would violate applicable nonbankruptcy law.

(2) If notification is required under subsection (a) of section 7A of the Clayton Act in the case of a transaction under this subsection, then—

(A) notwithstanding subsection (a) of such section, the notification required by such subsection to be given by the debtor shall be given by the trustee; and

(B) notwithstanding subsection (b) of such section, the required waiting period shall end on the 15th day after the date of the receipt, by the Federal Trade Commission and the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice, of the notification required under such subsection (a), unless such waiting period is extended—

(i) pursuant to subsection (e)(2) of such section, in the same manner as such subsection (e)(2) applies to a cash tender offer;

(ii) pursuant to subsection (g)(2) of such section; or

(iii) by the court after notice and a hearing.

(c) (1) If the business of the debtor is authorized to be operated under section 721, 1108, 1203, 1204, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

(2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless—

(A) each entity that has an interest in such cash collateral consents; or

(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

(3) Any hearing under paragraph (2)(B) of this subsection may be a preliminary hearing or may be consolidated with a hearing under subsection (e) of this section, but shall be scheduled in accordance with the needs of the debtor. If the hearing under paragraph (2)(B) of this subsection is a preliminary hearing, the court may authorize such use, sale, or lease only if there is a reasonable likelihood that the trustee will prevail at the final hearing under subsection (e) of this section. The court shall act promptly on any request for authorization under paragraph (2)(B) of this subsection.

(4) Except as provided in paragraph (2) of this subsection, the trustee shall segregate and account for any cash collateral in the trustee's possession, custody, or control.

(d) The trustee may use, sell, or lease property under subsection (b) or (c) of this section—

(1) in the case of a debtor that is a corporation or trust that is not a moneyed business, commercial corporation, or trust, only in accordance with nonbankruptcy law applicable to the transfer of property by a debtor that is such a corporation or trust; and

(2) only to the extent not inconsistent with any relief granted under subsection (c), (d), (e), or (f) of section 362.

(e) Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. This subsection also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362).

(f) The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

(g) Notwithstanding subsection (f) of this section, the trustee may sell property under subsection (b) or (c) of this section free and clear of any vested or contingent right in the nature of dower or curtesy.

(h) Notwithstanding subsection (f) of this section, the trustee may sell both the estate's interest, under subsection (b) or (c) of this section, and the interest of any co-owner in property in which the debtor had, at the time of the commencement of the case, an undivided interest as a tenant in common, joint tenant, or tenant by the entirety, only if—

(1) partition in kind of such property among the estate and such co-owners is impracticable;

(2) sale of the estate's undivided interest in such property would realize significantly less for the estate than sale of such property free of the interests of such co-owners;

(3) the benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners; and

(4) such property is not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light, or power.

(i) Before the consummation of a sale of property to which subsection (g) or (h) of this section applies, or of property of the estate that was community property of the debtor and the debtor's spouse immediately before the commencement of the case, the debtor's spouse, or a co-owner of such property, as the case may be, may purchase such property at the price at which such sale is to be consummated.

(j) After a sale of property to which subsection (g) or (h) of this section applies, the trustee shall distribute to the debtor's spouse or the co-owners of such property, as the case may be, and to the estate, the proceeds of such sale, less the costs and expenses, not including any com-

pensation of the trustee, of such sale, according to the interests of such spouse or co-owners, and of the estate.

(k) At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

(*l*) Subject to the provisions of section 365, the trustee may use, sell, or lease property under subsection (b) or (c) of this section, or a plan under chapter 11, 12, or 13 of this title may provide for the use, sale, or lease of property, notwithstanding any provision in a contract, a lease, or applicable law that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title concerning the debtor, or on the appointment of or the taking possession by a trustee in a case under this title or a custodian, and that effects, or gives an option to effect, a forfeiture, modification, or termination of the debtor's interest in such property.

(m) The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

(n) The trustee may avoid a sale under this section if the sale price was controlled by an agreement among potential bidders at such sale, or may recover from a party to such agreement any amount by which the value

of the property sold exceeds the price at which such sale was consummated, and may recover any costs, attorneys' fees, or expenses incurred in avoiding such sale or recovering such amount. In addition to any recovery under the preceding sentence, the court may grant judgment for punitive damages in favor of the estate and against any such party that entered into such an agreement in willful disregard of this subsection.

(*o*) Notwithstanding subsection (f), if a person purchases any interest in a consumer credit transaction that is subject to the Truth in Lending Act or any interest in a consumer credit contract (as defined in section 433.1 of title 16 of the Code of Federal Regulations (January 1, 2004), as amended from time to time), and if such interest is purchased through a sale under this section, then such person shall remain subject to all claims and defenses that are related to such consumer credit transaction or such consumer credit contract, to the same extent as such person would be subject to such claims and defenses of the consumer had such interest been purchased at a sale not under this section.

(p) In any hearing under this section—

(1) the trustee has the burden of proof on the issue of adequate protection; and

(2) the entity asserting an interest in property has the burden of proof on the issue of the validity, priority, or extent of such interest.

11 U.S.C. § 507. Priorities

(a) The following expenses and claims have priority in the following order:

(1) First:

(A) Allowed unsecured claims for domestic support obligations that, as of the date of the filing of the petition in a case under this title, are owed to or recoverable by a spouse, former spouse, or child of the debtor, or such child's parent, legal guardian, or responsible relative, without regard to whether the claim is filed by such person or is filed by a governmental unit on behalf of such person, on the condition that funds received under this paragraph by a governmental unit under this title after the date of the filing of the petition shall be applied and distributed in accordance with applicable nonbankruptcy law.

(B) Subject to claims under subparagraph (A), allowed unsecured claims for domestic support obligations that, as of the date of the filing of the petition, are assigned by a spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative to a governmental unit (unless such obligation is assigned voluntarily by the spouse, former spouse, child, parent, legal guardian, or responsible relative of the child for the purpose of collecting the debt) or are owed directly to or recoverable by a governmental unit under applicable nonbankruptcy law, on the condition that funds received under this paragraph by a governmental unit under this title after the date of the filing of the petition be applied and distributed in accordance with applicable nonbankruptcy law.

(C) If a trustee is appointed or elected under section 701, 702, 703, 1104, 1202, or 1302, the administrative expenses of the trustee allowed

under paragraphs (1)(A), (2), and (6) of section 503(b) shall be paid before payment of claims under subparagraphs (A) and (B), to the extent that the trustee administers assets that are otherwise available for the payment of such claims.

(2) Second, administrative expenses allowed under section 503(b) of this title, unsecured claims of any Federal reserve bank related to loans made through programs or facilities authorized under section 13(3) of the Federal Reserve Act (12 U.S.C. 343), and any fees and charges assessed against the estate under chapter 123 of title 28.

(3) Third, unsecured claims allowed under section 502(f) of this title.

(4) Fourth, allowed unsecured claims, but only to the extent of $10,000 for each individual or corporation, as the case may be, earned within 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first, for—

(A) wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual; or

(B) sales commissions earned by an individual or by a corporation with only 1 employee, acting as an independent contractor in the sale of goods or services for the debtor in the ordinary course of the debtor's business if, and only if, during the 12 months preceding that date, at least 75 percent of the amount that the individual or corporation earned by acting as an independent contractor in the sale of goods or services was earned from the debtor.

(5) Fifth, allowed unsecured claims for contributions to an employee benefit plan—

(A) arising from services rendered within 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first; but only

(B) for each such plan, to the extent of—

(i) the number of employees covered by each such plan multiplied by $10,000; less

(ii) the aggregate amount paid to such employees under paragraph (4) of this subsection, plus the aggregate amount paid by the estate on behalf of such employees to any other employee benefit plan.

(6) Sixth, allowed unsecured claims of persons—

(A) engaged in the production or raising of grain, as defined in section 557(b) of this title, against a debtor who owns or operates a grain storage facility, as defined in section 557(b) of this title, for grain or the proceeds of grain, or

(B) engaged as a United States fisherman against a debtor who has acquired fish or fish produce from a fisherman through a sale or conversion, and who is engaged in operating a fish produce storage or processing facility—

but only to the extent of $4,000 for each such individual.

(7) Seventh, allowed unsecured claims of individuals, to the extent of $1,800 for each such individual, arising from the deposit, before the commencement of the case, of money in connection with the purchase, lease, or rental of property, or the

purchase of services, for the personal, family, or household use of such individuals, that were not delivered or provided.

(8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for—

(A) a tax on or measured by income or gross receipts for a taxable year ending on or before the date of the filing of the petition—

(i) for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;

(ii) assessed within 240 days before the date of the filing of the petition, exclusive of—

(I) any time during which an offer in compromise with respect to that tax was pending or in effect during that 240-day period, plus 30 days; and

(II) any time during which a stay of proceedings against collections was in effect in a prior case under this title during that 240-day period, plus 90 days; or

(iii) other than a tax of a kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;

(B) a property tax incurred before the commencement of the case and last payable

without penalty after one year before the date of the filing of the petition;

(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;

(D) an employment tax on a wage, salary, or commission of a kind specified in paragraph (4) of this subsection earned from the debtor before the date of the filing of the petition, whether or not actually paid before such date, for which a return is last due, under applicable law or under any extension, after three years before the date of the filing of the petition;

(E) an excise tax on—

(i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

(ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition;

(F) a customs duty arising out of the importation of merchandise—

(i) entered for consumption within one year before the date of the filing of the petition;

(ii) covered by an entry liquidated or reliquidated within one year before the date of the filing of the petition; or

(iii) entered for consumption within four years before the date of the filing of the petition but unliquidated on such date, if the Secretary of the Treasury certifies that failure to liquidate such entry was due to an investigation pending on such date into assessment of antidumping or countervailing duties or fraud, or if information needed for the proper appraisement or classification of such merchandise was not available to the appropriate customs officer before such date; or

(G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.

An otherwise applicable time period specified in this paragraph shall be suspended for any period during which a governmental unit is prohibited under applicable nonbankruptcy law from collecting a tax as a result of a request by the debtor for a hearing and an appeal of any collection action taken or proposed against the debtor, plus 90 days; plus any time during which the stay of proceedings was in effect in a prior case under this title or during which collection was precluded by the existence of 1 or more confirmed plans under this title, plus 90 days.

(9) Ninth, allowed unsecured claims based upon any commitment by the debtor to a Federal depository institutions regulatory agency (or predecessor to such agency) to maintain the capital of an insured depository institution.

(10) Tenth, allowed claims for death or personal injury resulting from the operation of a motor vehicle or vessel if such operation was unlawful because

the debtor was intoxicated from using alcohol, a drug, or another substance.

(b) If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(2) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

(c) For the purpose of subsection (a) of this section, a claim of a governmental unit arising from an erroneous refund or credit of a tax has the same priority as a claim for the tax to which such refund or credit relates.

(d) An entity that is subrogated to the rights of a holder of a claim of a kind specified in subsection (a)(1), (a)(4), (a)(5), (a)(6), (a)(7), (a)(8), or (a)(9) of this section is not subrogated to the right of the holder of such claim to priority under such subsection.

11 U.S.C. § 726. Distribution of property of the estate

(a) Except as provided in section 510 of this title, property of the estate shall be distributed—

(1) first, in payment of claims of the kind specified in, and in the order specified in, section 507 of this title, proof of which is timely filed under section 501 of this title or tardily filed on or before the earlier of—

(A) the date that is 10 days after the mailing to creditors of the summary of the trustee's final report; or

(B) the date on which the trustee commences final distribution under this section;

(2) second, in payment of any allowed unsecured claim, other than a claim of a kind specified in paragraph (1), (3), or (4) of this subsection, proof of which is—

(A) timely filed under section 501(a) of this title;

(B) timely filed under section 501(b) or 501(c) of this title; or

(C) tardily filed under section 501(a) of this title, if—

(i) the creditor that holds such claim did not have notice or actual knowledge of the case in time for timely filing of a proof of such claim under section 501(a) of this title; and

(ii) proof of such claim is filed in time to permit payment of such claim;

(3) third, in payment of any allowed unsecured claim proof of which is tardily filed under section 501(a) of this title, other than a claim of the kind specified in paragraph (2)(C) of this subsection;

(4) fourth, in payment of any allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, arising before the earlier of the order for relief or the appointment of a trustee, to the extent that such fine, penalty, forfeiture, or damag-

es are not compensation for actual pecuniary loss suffered by the holder of such claim;

(5) fifth, in payment of interest at the legal rate from the date of the filing of the petition, on any claim paid under paragraph (1), (2), (3), or (4) of this subsection; and

(6) sixth, to the debtor.

(b) Payment on claims of a kind specified in paragraph (1), (2), (3), (4), (5), (6), (7), (8), (9), or (10) of section 507(a) of this title, or in paragraph (2), (3), (4), or (5) of subsection (a) of this section, shall be made pro rata among claims of the kind specified in each such particular paragraph, except that in a case that has been converted to this chapter under section 1112, 1208, or 1307 of this title, a claim allowed under section 503(b) of this title incurred under this chapter after such conversion has priority over a claim allowed under section 503(b) of this title incurred under any other chapter of this title or under this chapter before such conversion and over any expenses of a custodian superseded under section 543 of this title.

(c) Notwithstanding subsections (a) and (b) of this section, if there is property of the kind specified in section 541(a)(2) of this title, or proceeds of such property, in the estate, such property or proceeds shall be segregated from other property of the estate, and such property or proceeds and other property of the estate shall be distributed as follows:

(1) Claims allowed under section 503 of this title shall be paid either from property of the kind specified in section 541(a)(2) of this title, or from other property of the estate, as the interest of justice requires.

(2) Allowed claims, other than claims allowed under section 503 of this title, shall be paid in the order specified in subsection (a) of this section, and, with respect to claims of a kind specified in a particular paragraph of section 507 of this title or subsection (a) of this section, in the following order and manner:

(A) First, community claims against the debtor or the debtor's spouse shall be paid from property of the kind specified in section 541(a)(2) of this title, except to the extent that such property is solely liable for debts of the debtor.

(B) Second, to the extent that community claims against the debtor are not paid under subparagraph (A) of this paragraph, such community claims shall be paid from property of the kind specified in section 541(a)(2) of this title that is solely liable for debts of the debtor.

(C) Third, to the extent that all claims against the debtor including community claims against the debtor are not paid under subparagraph (A) or (B) of this paragraph such claims shall be paid from property of the estate other than property of the kind specified in section 541(a)(2) of this title.

(D) Fourth, to the extent that community claims against the debtor or the debtor's spouse are not paid under subparagraph (A), (B), or (C) of this paragraph, such claims shall be paid from all remaining property of the estate.

11 U.S.C. § 1112. Conversion or dismissal

(a) The debtor may convert a case under this chapter to a case under chapter 7 of this title unless—

(1) the debtor is not a debtor in possession;

(2) the case originally was commenced as an involuntary case under this chapter; or

(3) the case was converted to a case under this chapter other than on the debtor's request.

(b) (1) Except as provided in paragraph (2) and subsection (c), on request of a party in interest, and after notice and a hearing, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate.

(2) The court may not convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter if the court finds and specifically identifies unusual circumstances establishing that converting or dismissing the case is not in the best interests of creditors and the estate, and the debtor or any other party in interest establishes that—

(A) there is a reasonable likelihood that a plan will be confirmed within the timeframes established in sections 1121(e) and 1129(e) of this title, or if such sections do not apply, within a reasonable period of time; and

(B) the grounds for converting or dismissing the case include an act or omission of the debtor other than under paragraph (4)(A)—

(i) for which there exists a reasonable justification for the act or omission; and

(ii) that will be cured within a reasonable period of time fixed by the court.

(3) The court shall commence the hearing on a motion under this subsection not later than 30 days after filing of the motion, and shall decide the motion not later than 15 days after commencement of such hearing, unless the movant expressly consents to a continuance for a specific period of time or compelling circumstances prevent the court from meeting the time limits established by this paragraph.

(4) For purposes of this subsection, the term "cause" includes—

(A) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;

(B) gross mismanagement of the estate;

(C) failure to maintain appropriate insurance that poses a risk to the estate or to the public;

(D) unauthorized use of cash collateral substantially harmful to 1 or more creditors;

(E) failure to comply with an order of the court;

(F) unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter;

(G) failure to attend the meeting of creditors convened under section 341(a) or an exam-

ination ordered under rule 2004 of the Federal Rules of Bankruptcy Procedure without good cause shown by the debtor;

(H) failure timely to provide information or attend meetings reasonably requested by the United States trustee (or the bankruptcy administrator, if any);

(I) failure timely to pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief;

(J) failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court;

(K) failure to pay any fees or charges required under chapter 123 of title 28;

(L) revocation of an order of confirmation under section 1144;

(M) inability to effectuate substantial consummation of a confirmed plan;

(N) material default by the debtor with respect to a confirmed plan;

(O) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan; and

(P) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition.

(c) The court may not convert a case under this chapter to a case under chapter 7 of this title if the debtor is a farmer or a corporation that is not a mon-

eyed, business, or commercial corporation, unless the debtor requests such conversion.

(d) The court may convert a case under this chapter to a case under chapter 12 or 13 of this title only if—

(1) the debtor requests such conversion;

(2) the debtor has not been discharged under section 1141(d) of this title; and

(3) if the debtor requests conversion to chapter 12 of this title, such conversion is equitable.

(e) Except as provided in subsections (c) and (f), the court, on request of the United States trustee, may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate if the debtor in a voluntary case fails to file, within fifteen days after the filing of the petition commencing such case or such additional time as the court may allow, the information required by paragraph (1) of section 521(a), including a list containing the names and addresses of the holders of the twenty largest unsecured claims (or of all unsecured claims if there are fewer than twenty unsecured claims), and the approximate dollar amounts of each of such claims.

(f) Notwithstanding any other provision of this section, a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such chapter.

11 U.S.C. § 1129. Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

(1) The plan complies with the applicable provisions of this title.

(2) The proponent of the plan complies with the applicable provisions of this title.

(3) The plan has been proposed in good faith and not by any means forbidden by law.

(4) Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable.

(5) (A) (i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and

(ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and

(B) the proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.

(6) Any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate

change provided for in the plan, or such rate change is expressly conditioned on such approval.

(7) With respect to each impaired class of claims or interests—

(A) each holder of a claim or interest of such class—

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

(8) With respect to each class of claims or interests—

(A) such class has accepted the plan; or

(B) such class is not impaired under the plan.

(9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that—

(A) with respect to a claim of a kind specified in section 507(a)(2) or 507(a)(3) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;

(B) with respect to a class of claims of a kind specified in section 507(a)(1), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title, each holder of a claim of such class will receive—

(i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim;

(C) with respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive on account of such claim regular installment payments in cash—

(i) of a total value, as of the effective date of the plan, equal to the allowed amount of such claim;

(ii) over a period ending not later than 5 years after the date of the order for relief under section 301, 302, or 303; and

(iii) in a manner not less favorable than the most favored nonpriority unsecured claim provided for by the plan (other than cash payments made to a class of creditors under section 1122(b)); and

(D) with respect to a secured claim which would otherwise meet the description of an unsecured claim of a governmental unit under section 507(a)(8), but for the secured status of that claim, the holder of that claim will receive on account of that claim, cash payments, in the same manner and over the same period, as prescribed in subparagraph (C).

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

(12) All fees payable under section 1930 of title 28, as determined by the court at the hearing on confirmation of the plan, have been paid or the plan provides for the payment of all such fees on the effective date of the plan.

(13) The plan provides for the continuation after its effective date of payment of all retiree benefits, as that term is defined in section 1114 of this title, at the level established pursuant to subsection (e)(1)(B) or (g) of section 1114 of this title, at any time prior to confirmation of the plan, for the duration of the period the debtor has obligated itself to provide such benefits.

(14) If the debtor is required by a judicial or administrative order, or by statute, to pay a domes-

tic support obligation, the debtor has paid all amounts payable under such order or such statute for such obligation that first become payable after the date of the filing of the petition.

(15) In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan—

(A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

(B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.

(16) All transfers of property under the plan shall be made in accordance with any applicable provisions of nonbankruptcy law that govern the transfer of property by a corporation or trust that is not a moneyed, business, or commercial corporation or trust.

(b) (1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with re-

spect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides—

(i) (I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.

(C) With respect to a class of interests—

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

(c) Notwithstanding subsections (a) and (b) of this section and except as provided in section 1127(b) of this title, the court may confirm only one plan, unless the order of confirmation in the case has been revoked under section 1144 of this title. If the requirements of

subsections (a) and (b) of this section are met with respect to more than one plan, the court shall consider the preferences of creditors and equity security holders in determining which plan to confirm.

(d) Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933. In any hearing under this subsection, the governmental unit has the burden of proof on the issue of avoidance.

(e) In a small business case, the court shall confirm a plan that complies with the applicable provisions of this title and that is filed in accordance with section 1121(e) not later than 45 days after the plan is filed unless the time for confirmation is extended in accordance with section 1121(e)(3).

Fed. R. Bankr. P. 9019. Compromise and Arbitration

(a) Compromise. On motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement. Notice shall be given to creditors, the United States trustee, the debtor, and indenture trustees as provided in Rule 2002 and to any other entity as the court may direct.

(b) Authority to Compromise or Settle Controversies within Classes. After a hearing on such notice as the court may direct, the court may fix a class or classes of controversies and authorize the trustee to compromise or settle controversies within such class or classes without further hearing or notice.

(c) Arbitration. On stipulation of the parties to any controversy affecting the estate the court may authorize the matter to be submitted to final and binding arbitration.

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No. 15-649

IN THE
Supreme Court of the United States

CASIMIR CZYZEWSKI, *et al.*,

Petitioners,

v.

JEVIC HOLDING CORP., *et al.*,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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October 12, 2016

QUESTION PRESENTED

The petition for certiorari presented the following question:

Whether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme.

CORPORATE DISCLOSURE STATEMENT

Respondent Sun Capital Partners, Inc. has no parent corporation and no publicly held company has a 10% or greater ownership interest.

Respondent Sun Capital Partners IV, LP, has no parent corporation and no publicly held company has a 10% or greater ownership interest.

Respondent Sun Capital Partners Management IV, LLC is wholly owned by Sun Capital Advisors IV, LP, and no publicly held company has a 10% or greater ownership interest.

Respondent The CIT Group/Business Credit, Inc. is a wholly owned subsidiary of CIT Group Inc., which is a publicly traded company. No individual shareholder holds 10% or more of the stock of CIT Group Inc.

Respondent Jevic Holding Corp. is wholly owned by Sun Transportation LLC and HIG Sun Partners, Inc., and no publicly held company owns 10% of more of its stock.

Respondent Jevic Transportation Inc. is a wholly owned subsidiary of Jevic Holding Corp., and no publicly held company holds 10% or more of its stock.

Respondent Creek Road Properties, LLC is a wholly owned subsidiary of respondent Jevic Transportation Inc., and no publicly held company owns 10% or more of its stock.

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INTRODUCTION

This is a contrived case. Petitioners were holdouts from a global settlement involving all other stakeholders in a Chapter 11 bankruptcy. Although the settlement left petitioners free to pursue the claims they refused to settle, they asked the bankruptcy court to reject the settlement, but failed to prove (or even to argue) that such rejection would leave anyone—*including petitioners themselves*—better off. The bankruptcy court made factual findings, which both the district court and the Third Circuit left undisturbed, that the alternative to this settlement was not confirmation of a Chapter 11 plan of reorganization, but conversion of this case to a Chapter 7 liquidation, with all of the estates' remaining assets being distributed in short order to the debtors' secured creditors, respondents The CIT Group/Business Credit, Inc., as agent for the Lender Group (CIT), and Sun Capital Partners IV, LP (Sun Fund IV). In other words, if petitioners succeed in overturning the settlement, they will not get a penny, but will wreak havoc on all other unsecured creditors (including priority creditors like federal and state taxing authorities and more than 1,000 general unsecured creditors) who received and cashed their distribution checks under the settlement three years ago.

Petitioners insist that this result is necessary to vindicate what they view as the proper operation of the Bankruptcy Code. As counsel for the U.S. Trustee, supporting petitioners, told the bankruptcy court: "'[W]e have to accept the fact that we are sometimes going to get a really ugly result, an economically ugly result, but it's an economically

ugly result that is dictated by the provisions of the code.'" Pet. App. 23a (quoting CA3 App. 1327). But federal courts sit to resolve "cases" or "controversies," not to vindicate an alleged interest in the proper operation of the law. Petitioners were repeatedly asked point-blank in the Third Circuit what relief they were seeking here, and repeatedly answered that it was conversion to a Chapter 7 liquidation. *See* Resps.' Supp. Br., Supp. App. 19-22a, 60a. In light of the bankruptcy court's factual findings, endorsed by both the district court and the Third Circuit, that petitioners would recover *nothing* in a Chapter 7 liquidation, this dispute does not present an Article III case or controversy.

And even assuming that this Court were to reach the question on which it granted certiorari—whether bankruptcy courts must apply the Code's priority system not only to *plans of reorganization* but also to *settlements* in Chapter 11—petitioners fare no better. The Code's plain text applies the priority system to a "plan," 11 U.S.C. § 1129(b)(2)(B)(ii), but there is no corresponding provision for a settlement. The Fifth Circuit decision on which petitioners relied in their petition, *In re AWECO, Inc.*, 725 F.2d 293 (5th Cir. 1984), identified no textual basis for its approach, but instead invoked "policy arguments," *id.* at 298. As the Second Circuit noted in *In re Iridium Operating LLC*, 478 F.3d 452, 464 (2d Cir. 2007), and the Third Circuit reaffirmed here, "policy arguments" cut *against* the Fifth Circuit's atextual *per se* rule, and favor a more pragmatic approach that, in rare cases, allows bankruptcy courts to approve settlements that do not follow the Code's priority system. Indeed, nothing in the Code either authorizes or requires bankruptcy courts to review

and approve Chapter 11 settlements in the first place, so it follows *a fortiori* that nothing in the Code authorizes or requires such courts to apply the priority system to such settlements.

Understandably reluctant to defend the *AWECO* rule underlying the alleged circuit conflict on which they sought and obtained this Court's review, petitioners now try to change the subject entirely. Thus, they focus their merits argument not on the applicability of the Code's priority system to settlements, but instead on the validity of "structured dismissals" under which a bankruptcy court dismisses a Chapter 11 case "for cause" under 11 U.S.C. §§ 349(b) and 1112(b). Indeed, petitioners alter the question presented by replacing a reference to a "settlement" with a reference to a "structured dismissal," *compare* Pet. i *with* Petrs.' Br. i, and relegate the only reference to *AWECO* in the argument section of their merits brief to a passing footnote, *see id.* at 32 n.6. The validity of a structured dismissal is not fairly included within the question presented in the petition, and there is no circuit conflict on that issue; to the contrary, neither *AWECO* nor *Iridium* involved a structured dismissal at all. This Court's rules do not allow such transparent "bait and switch" tactics, and respondents certainly will not take the bait.

That point brings back matters full circle to the starting point of this brief: this is a contrived case. Petitioners will not benefit from a favorable ruling, but challenged the settlement below in the hopes of obtaining an advisory opinion "that people can count on and negotiate against in bankruptcy." Resps.' Supp. Br., Supp. App. 60a. The crux of that

challenge below was that the settlement does not satisfy the legal standard set forth by the Second Circuit in *Iridium*, which, as the Third Circuit noted, petitioners "cite throughout their briefs and never quarrel with." Pet. App. 19a. After the Third Circuit adopted and applied the *Iridium* standard, petitioners sought and obtained this Court's review by challenging that standard as inconsistent with the Fifth Circuit's decision in *AWECO*. At the merits stage, petitioners now ask this Court to rule on the validity of "structured dismissals," although that issue does not implicate the circuit conflict cited in their petition and is not fairly included in the question presented. Enough is enough. This Court should either dismiss the case for lack of jurisdiction, or affirm the judgment on the merits.

PERTINENT STATUTORY PROVISIONS

Petitioners have included pertinent statutes and rules in an Appendix to their merits brief. Excerpts from other pertinent statutes, the Bankruptcy Act of 1898, 55th Cong., 2d Sess., 30 Stat. 544 (1898), and the Act of June 22, 1938, 75th Cong., 3rd Sess., 52 Stat. 840 (1938), are reproduced in a Supplemental Appendix ("Supp. App.") attached to this brief.

STATEMENT OF THE CASE

A. Background

Respondent Jevic Transportation, Inc. was a New Jersey trucking company. Pet. App. 2a. In 2006, as the company teetered on the brink of insolvency, it was acquired by respondent Sun Fund IV in a buyout financed with a loan later refinanced by a group of lenders led by respondent CIT and secured by a lien on all of Jevic's assets. *Id.*; Pet. App. 53a; JA230.

Jevic's fortunes, however, failed to improve, and in January 2008, the company reached a forbearance agreement with CIT—which included a $2 million guarantee by Sun Fund IV—to prevent foreclosure. Pet. App. 2a. As Jevic's situation worsened in early 2008, Sun Fund IV was forced to make a $2 million guarantee payment to CIT, and thereby acquired its own $2 million secured lien on Jevic's assets. JA206.

With the advent of the Great Recession in the spring of 2008, Jevic's board of directors decided to seek bankruptcy protection. Pet. App. 2a. On May 19, 2008, the company ceased substantially all operations, and its employees received termination notices. *Id.*; JA206.

B. Proceedings Below

1. Bankruptcy Court

The next day, Jevic and two affiliated companies filed voluntary Chapter 11 petitions in the U.S. Bankruptcy Court for the District of Delaware. Pet. App. 3a. At that time, Jevic owed about $53 million to its secured creditors, respondents CIT and Sun Fund IV, and over $20 million to its unsecured creditors, including tax and general creditors. *Id.*; JA206. The U.S. Trustee thereafter appointed the Official Committee of Unsecured Creditors to represent Jevic's unsecured creditors.

Because Jevic had no real prospect of reorganizing, it began the process of liquidating its assets to pay its creditors. Pet. App. 36a. (As petitioners acknowledge, Chapter 11 authorizes liquidation as well as reorganization under certain circumstances. *See* Petrs.' Br. 7 (citing 11 U.S.C. § 1123(b)(4)). CIT provided post-petition debtor-in-possession financing

to fund this asset-sale process. JA206. Jevic's prior obligations to CIT were "rolled up" into this new financing facility. Pet. App. 54a; JA206-07. Under the terms of this financing, Jevic agreed to waive any challenge to the validity, enforceability, or priority of CIT's secured claims, but the Committee was granted standing to step into Jevic's shoes to raise those challenges. JA23-24, 231. The Committee then brought a fraudulent conveyance action on behalf of the Jevic bankruptcy estates against CIT, Sun Fund IV, and two other Sun entities, respondents Sun Capital Partners Management IV, LLC and Sun Capital Partners, Inc. (SCPI), arising from the leveraged buyout of Jevic. Pet. App. 3a.

In addition, petitioners (former Jevic employees) brought a class action against Jevic and SCPI (on a putative "single employer" theory) seeking forward-looking statutory damages under the Worker Adjustment and Retraining Notification Act (WARN), 29 U.S.C. § 2102, and its New Jersey state-law counterpart, which generally require employers to provide workers with 60 days' notice before termination. Pet. App. 3a. Separately, individual employees also filed claims "for unpaid wages and benefits" accrued through their date of termination. Pet. 2. Jevic paid in full all of its former employees' claims for unpaid wages and benefits through the date of their termination, including $3 million in accrued vacation and health insurance benefits. JA206, 226-27.

In September 2011, the bankruptcy court (Shannon, J.) granted in part and denied in part a motion to dismiss the Committee's fraudulent conveyance action. JA20-52. The court dismissed

the claims for fraudulent transfer under 11 U.S.C. § 544, for equitable subordination of CIT's $53 million claim against the Jevic bankruptcy estates, and for aiding and abetting Jevic's officers and directors in allegedly breaching their fiduciary duties. JA43-44, 47-51. At the same time, the court concluded that the Committee had adequately pleaded preference and fraudulent conveyance claims under 11 U.S.C. §§ 547 and 548. JA36-42, 44-47. Despite holding that these claims survived dismissal on the pleadings, the court acknowledged that the defenses "may ultimately prove fatal" to the claims, and that "the Committee will still need to marshal evidence" to overcome those defenses. JA35, 39.

Soon thereafter, the parties sought to settle the long-running fraudulent conveyance action and wrap up the entire bankruptcy. Pet. App. 4a. By then, the Committee was wary about continuing to pursue what would likely be "very protracted and expensive" litigation against well-funded adversaries. JA232, 235. Because discovery was in the earliest stages and the "long litany of affirmative defenses" raised posed "significant obstacles" to any recovery, the Committee recognized that litigating the claim to judgment would take years and cost millions of dollars. JA233-36. The Jevic bankruptcy estates were administratively insolvent, had no unencumbered assets to fund the litigation, and could not secure trial counsel willing to take the case on a contingency basis. JA207-08, 233, 235.

The settlement negotiations initially involved all major economic stakeholders, including Jevic, the Committee, the Sun entities, CIT, and petitioners.

Pet. App. 55a, 59a. Jevic made "numerous efforts" to include petitioners in the settlement. JA210, 222. But petitioners refused to join the settlement of the fraudulent conveyance claim unless they also received what they believed to be the full value of their WARN claim against SCPI. JA233. Sun, however, was unwilling either to accede to this attempt to "hold up" the fraudulent conveyance settlement as leverage to settle what Sun believed to be a meritless claim (as it was ultimately determined to be), or to enter into a partial settlement with petitioners that would fund the ongoing WARN litigation. JA245-46. As a result, the final settlement agreement resolved all disputes among all stakeholders *except* petitioners, who chose to continue pursuing their WARN claims against SCPI and Jevic rather than participate in the settlement of the estates' fraudulent conveyance claim. *See* Pet. App. 59a ("It is clear that the [WARN] claimants were invited to and took part in th[e] settlement process, but they have chosen not to be part of this settlement.").

In June 2012—pursuant to Third Circuit precedent that requires bankruptcy court approval of all settlements in Chapter 11, *see, e.g.*, *Northview Motors, Inc. v. Chrysler Motors Corp.*, 186 F.3d 346, 351 n.4. (3d Cir. 1999); *In re Martin*, 91 F.3d 389, 393 (3d Cir. 1996); *see generally* Fed. R. Bankr. P. 9019—respondents filed a joint motion asking the bankruptcy court to (1) approve their settlement, and (2) dismiss the Chapter 11 cases upon implementation of the settlement. *See* JA158-82. Under the settlement, in exchange for dismissal of the fraudulent conveyance action, CIT agreed to pay $2 million into an account earmarked for the estates'

unpaid administrative expenses, and Sun Fund IV assigned its lien on Jevic's remaining $1.7 million in cash to a trust, which would first pay various priority unsecured creditors and then pay general unsecured creditors on a *pro rata* basis. JA186-92; *see also* Pet. App. 5a.

Petitioners objected to the proposed settlement. However, at a November 2012 evidentiary hearing, they presented no evidence of their own, and mounted no real challenge to any of respondents' evidence. Instead, petitioners insisted that the settlement was invalid as a matter of law because it did not follow the Code's priority system insofar as it allocated proceeds to general unsecured creditors but not to petitioners, who held a disputed priority unsecured claim (their WARN claim) against the Jevic estate.

The bankruptcy court rejected that argument. In an oral ruling in December 2012, the court acknowledged that "the proposed distributions are not in accordance with the absolute priority rule" because some settlement funds flowed to general unsecured creditors with a lower statutory priority than petitioners. Pet. App. 58a. That point, however, was not dispositive: "[B]ecause this is not a plan, and there is no prospect here of a confirmable plan being filed, the absolute priority rule is not a bar to approval of this settlement." *Id.*

The bankruptcy court proceeded to approve the settlement based on "dire circumstances." *See* Pet. App. 45-52a, 53-66a. In particular, the fraudulent conveyance claim was a long shot that the bankruptcy estates lacked funds to pursue and was an unattractive case for contingency counsel. Pet.

App. 61a ("[O]n these facts I think any lawyer or firm that signed up for that role should have his head examined."). Neither petitioners nor their counsel ever offered either to fund the litigation or to act as contingency counsel. Nor did they ever assert any interest in pursuing an individual fraudulent conveyance claim or ever ask the court to dismiss the case with no strings attached in order for them to do so.

In addition, the bankruptcy court held that dismissal of the Chapter 11 cases was appropriate because there was no feasible alternative and nothing further for the court to do in light of the settlement. The Chapter 11 cases had "been pending for years … with no reasonable prospect of a confirmable plan." Pet. App. 56a. There were "no assets or funds that are not subject to the liens of CIT and Sun Capital," no "resources to creditably prosecute the Committee's lawsuit," no "resources to, otherwise, wrap up these bankruptcy proceedings," and no reasonable prospect of a meaningful "distribution to unsecured creditors" absent the settlement. *Id.* Aside from the pending fraudulent conveyance action, "[a]ll material tasks needed to administer the estates ha[d] already been completed." *Id.*

Nor was conversion to a Chapter 7 liquidation a feasible alternative. A Chapter 7 trustee would have no "money to operate, investigate or litigate" the claims, and the secured creditors, respondents CIT and Sun Fund IV, "have stated unequivocally and credibly that they would not do this deal in a Chapter 7." Pet. App. 58a. Thus, in the event of a Chapter 7 conversion, "the settlement proceeds

would be taken by the secured creditors in relatively short order … with nothing left over for stakeholders." *Id.* Faced "with two options, a meaningful return or zero," the court chose the former. Pet. App. 61a.

Petitioners thereafter moved for a stay pending appeal in the bankruptcy court. After the bankruptcy court denied that request, however, petitioners did not seek a stay from the district court. Pet. App. 38a. In August 2013, respondents consummated the settlement, distributing 29 checks to various federal and state taxing authorities and more than 1,000 checks to general unsecured creditors. Pet. App. 39a. The bankruptcy court dismissed Jevic's Chapter 11 case on October 11, 2013. *Id.*

Meanwhile, in May 2013, the bankruptcy court issued two important rulings in the ongoing WARN litigation. *First*, the court granted SCPI summary judgment on the ground that it was not a "single employer" with Jevic for purposes of WARN liability under either federal or state law. *See In re Jevic Holding Corp.*, 492 B.R. 416, 433 (Bankr. D. Del. 2013). Both the district court and the Third Circuit subsequently affirmed that decision. *See* 526 B.R. 547 (D. Del. 2014); __ F. App'x __, 2016 WL 4011149 (3d Cir. July 27, 2016). *Second*, the bankruptcy court held that petitioners failed to establish liability against Jevic under the federal WARN Act (which contains an exception for "business circumstances that were not reasonably foreseeable as of the time that notice would have been required," 29 U.S.C. § 2102(b)(2)(A)), but had established liability against Jevic under the New Jersey WARN Act (which

contains no such exception). *See In re Jevic Holding Corp.*, 496 B.R. 151, 165 (Bankr. D. Del. 2013).

2. District Court

Petitioners appealed the bankruptcy court's order approving the settlement to the district court, which affirmed in January 2014. *See* Pet. App. 35-43a. (Although the U.S. Trustee had also objected to the settlement in the bankruptcy court, it did not appeal the bankruptcy court's order.) The district court concluded that the bankruptcy court had not abused its discretion by deciding on this record that the settlement "was in the best interest of the estate and of resolving the pending Chapter 11 cases." Pet. App. 40-41a (citing *Martin*, 91 F.3d at 393).

In particular, the district court agreed with the bankruptcy court that the absolute priority rule, codified in 11 U.S.C. § 1129(b), applies only to Chapter 11 *plans*, not *settlements*. Because a settlement "is not a reorganization plan," it is subject only to the "criteria for approval under Bankruptcy Rule 9019 and the standards set forth under *In re Martin*." Pet. App. 42a (internal quotation omitted).

The district court held in the alternative that the appeal was equitably moot, applying a prudential doctrine recognized by the Third Circuit and several other courts of appeals in bankruptcy cases. *See, e.g.*, *In re Semcrude, L.P.*, 728 F.3d 314, 321 (3d Cir. 2013); *Duff v. Central Sleep Diagnostics, LLC*, 801 F.3d 833, 840 (7th Cir. 2015); *In re Charter Commc'ns, Inc.*, 691 F.3d 476, 479 (2d Cir. 2012). The district court held that (1) the settlement had been substantially consummated because all funds had been distributed; and (2) if petitioners' appeal succeeded, (a) the settlement would be irreversibly

scrambled, "as it did not provide for funds for appellants' speculative recovery and appellants chose not to substantively participate in the negotiation and subsequent settlement," and (b) the parties had negotiated a resolution "following years of litigation and will be harmed if the settlement is now unwound." Pet. App. 43a.

3. Third Circuit

Petitioners again appealed, and the Third Circuit affirmed. Pet. App. 1-32a. The court adopted the legal standard set forth by the Second Circuit in *Iridium*—"which, we note, [petitioners] … cite throughout their briefs and never quarrel with." Pet. App. 19a. Under that standard, "bankruptcy courts may approve settlements that deviate from the priority scheme of § 507 of the Bankruptcy Code," but "*only* if they have 'specific and credible grounds to justify [the] deviation." Pet. App. 21a (emphasis added; quoting *Iridium*, 478 F.3d at 466).

Applying the *Iridium* standard, the panel majority held that this was the "rare" case in which a bankruptcy court had discretion to approve a Chapter 11 settlement that did not follow the Code's priority system. Pet. App. 2a, 12a, 23a. The majority based that conclusion on the bankruptcy court's factual finding that the settlement here was "the least bad alternative since there was 'no prospect' of a plan being confirmed and conversion to Chapter 7 would have resulted in the secured creditors taking all that remained of the estate in 'short order.'" *Id.* at 21a (quoting Pet. App. 58a); *see also* Pet. App. 23a (highlighting the bankruptcy court's "sound findings of fact that the traditional routes out of Chapter 11 are unavailable and the

settlement is the best feasible way of serving the interests of the estate and its creditors"). "As in [*Iridium*], here the Bankruptcy Court had to choose between approving a settlement that deviated from the priority scheme of § 507 or rejecting it so a lawsuit could proceed to deplete the estate." Pet. App. 22a.

Judge Scirica concurred in part and dissented in part. As relevant here, he agreed with the majority's decision to "adopt the Second Circuit's standard from [*Iridium*]." Pet. App. 24a. He differed with the panel majority only with respect to the application of that legal standard to the facts of this case. Pet. App. 24-31a. In particular, he proposed unilaterally rewriting the settlement to provide petitioners a recovery in accordance with their statutory priority. Pet. App. 32a.

Petitioners sought rehearing *en banc*. *See* Br. in Opp., Supp. App. 1-17a. As relevant here, they did not challenge the panel's adoption of the Second Circuit's *Iridium* standard; rather, they argued only that the panel majority had *misapplied* that standard. *See id.* at 13-15a. Nor did petitioners argue that structured dismissals violate the Bankruptcy Code. *See* Opp. to Pet. for Rehearing En Banc at 10 n.1, *In re Jevic Holding Corp.*, 3d Cir. No. 14-1465 (Aug. 5, 2015). The Third Circuit denied the petition without recorded dissent. *See* Pet. App. 67-68a.

Petitioners then sought this Court's review. The petition presented a single question: "Whether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme." Pet. i. Petitioners

argued that "[t]here is a square and acknowledged split among the circuits" on that question. *Id.* at 15 (capitalization modified). On the one hand, they said, "[t]he Fifth Circuit has adopted a per se rule" under which bankruptcy courts may not approve a settlement that distributes estate assets in violation of the statutory priority scheme. *Id.* (citing *AWECO,* 725 F.2d at 298). On the other hand, they said, "[i]n the Second Circuit, ... a bankruptcy court may approve a pre-plan settlement that distributes estate assets in violation of the Code's priority rules." *Id.* at 16 (citing *Iridium*, 478 F.3d at 464). Petitioners argued that the Third Circuit erred by adopting the *Iridium* standard, which—according to petitioners—"cannot be squared with the text, structure, or purpose of the Code." *Id.* at 19. Petitioners thus urged this Court to "grant review and hold that settlement proceeds may not be distributed in violation of the Bankruptcy Code's priority scheme." *Id.* at 3.

As respondents pointed out in their opposition brief, petitioners had never challenged the *Iridium* standard in the Third Circuit. *See* Br. in Opp. 24; *see also* Resps.' Supp. Br. 4. In addition, respondents explained that the petition did not challenge structured dismissals, and indeed neither *AWECO* nor *Iridium* involved a structured dismissal. *See* Br. in Opp. 23 n.4; *see also* Resps.' Supp. Br. 3 n.1 (same). Petitioners did not dispute that point in their reply brief.

SUMMARY OF ARGUMENT

As the Third Circuit recognized, the bankruptcy court here acted well within its discretion by approving a Chapter 11 settlement that provided

some recovery for unsecured creditors, where the only feasible alternative was a Chapter 7 liquidation that would have provided *no* recovery for unsecured creditors (including petitioners).

That point has jurisdictional implications. There is no "case" or "controversy" within the meaning of Article III where, as here, petitioners cannot show that a favorable decision is likely to redress their alleged injury. Petitioners are simply seeking an advisory opinion on the proper operation of the Bankruptcy Code, but it is not the office of the Article III courts to expound on legal issues that will not benefit the parties invoking their jurisdiction.

Were this Court to reach the merits of the issue on which it granted review—the alleged conflict between *AWECO*, on the one hand, and *Iridium* and the decision below, on the other—it should affirm the decision below. As a threshold matter, nothing in the Code authorizes or requires bankruptcy courts to review and approve Chapter 11 settlements in the first place. The prior Bankruptcy Act did contain such a requirement, but it was scrapped when Congress adopted the Code in 1978 and limited the bankruptcy courts' involvement in the day-to-day administration of bankruptcy estates. And even assuming that the Code authorizes and requires bankruptcy courts to review Chapter 11 settlements, nothing in the Code specifies that such settlements must follow the Code's priority system. To the contrary, the Code's priority system applies to the treatment of dissenting classes of creditors under Chapter 11 *plans*. If Congress had wanted the Code's priority system to apply as well to Chapter 11 *settlements*, it could and would have said so.

Finally, this Court should reject petitioners' efforts to change the subject from the question whether bankruptcy courts must reject Chapter 11 settlements that do not follow the Code's priority system to the entirely different question whether a Chapter 11 case may ever terminate in a structured dismissal. The latter question has nothing to do with the circuit conflict identified in the petition, and is not fairly included in the question presented.

ARGUMENT

I. This Dispute Does Not Present A Justiciable "Case" Or "Controversy."

As a threshold matter, this dispute should be dismissed for lack of jurisdiction. Article III of the Constitution limits "[t]he judicial Power of the United States" to the resolution of "Cases" or "Controversies." U.S. Const. art. III §§ 1, 2. "[N]o principle is more fundamental to the judiciary's proper role in our system of government than the constitutional limitation of federal-court jurisdiction to actual cases or controversies." *Spokeo, Inc. v. Robins*, 136 S. Ct. 1540, 1547 (2016) (internal quotation omitted).

This dispute does not present a justiciable "case" or "controversy" because petitioners have failed to show that respondents have caused them an injury in fact "that is likely to be redressed by a favorable judicial decision," and thus lack standing to sue. *Id.*; *see also id.* ("Standing to sue is a doctrine rooted in the traditional understanding of a case or controversy."). Petitioners are challenging the settlement of a fraudulent conveyance claim against respondents CIT, Sun Fund IV, and two other Sun entities. That claim, which belonged to the Jevic

bankruptcy estates, was brought by the Official Committee of Unsecured Creditors, which was granted derivative standing by the bankruptcy court to pursue the claim on the estates' behalf. *See* Order (6/20/08) ¶ 39 at 24, *In re Jevic Holding Corp.*, Bankr. D. Del. No. 08-bk-11006, Dkt. 118.[1] Only the Official Committee—not petitioners—had standing to litigate (and therefore to settle) that claim on behalf of the estates.

The problem with petitioners' challenge to the settlement is that they have failed to show how a decision in their favor would benefit them—in Article III parlance, how such a decision would redress their alleged injury. *See*, *e.g.*, *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 102-04 (1998). If a court cannot afford a litigant relief that is likely to redress such an injury, the court is essentially being asked to render an impermissible "advisory opinion" in violation of Article III. *Id.* at 101; *see also Summers v. Earth Island Inst.*, 555 U.S. 488, 492-93 (2009).

The bankruptcy court in this case specifically found that there was "no reasonable prospect of a confirmable [Chapter 11] plan," because the debtors "lack the resources to ... wrap up these bankruptcy proceedings." Pet. App. 56a; *see also id.* ("In the absence of the settlement that is before the Court it is a virtual certainty that there will be no distribution to unsecured creditors here, and a

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[1] Under Third Circuit law, a bankruptcy court may in certain circumstances grant an Official Committee derivative standing to pursue a claim on behalf of a bankruptcy estate. *See Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 330 F.3d 548, 552-53 (3d Cir. 2003) (*en banc*).

substantial shortfall for distributions to administrative creditors."). Thus, the settlement was not an end run around the requirements for confirmation of such a plan. Rather, the court determined, the only feasible alternative to this settlement was conversion of the case to a Chapter 7 liquidation. Pet. App. 56-58a.[2]

And conversion to a Chapter 7 liquidation, the bankruptcy court further found, would benefit neither petitioners nor any of the other unsecured creditors. Pet. App. 56-61a. "The lenders [*i.e.*, respondents CIT and Sun Fund IV] have stated unequivocally and credibly that they would not do this deal in a Chapter 7," the estates had insufficient funds to pursue the fraudulent conveyance case on their own, and private counsel was unlikely to accept the case on a contingency basis. Pet. App. 58a; *id.* ("[I]n the event of a conversion it does not appear that a Chapter 7 Trustee would have any money to operate, investigate or litigate."); Pet. App. 61a ("[O]n these facts I think any lawyer or firm that signed up for th[e] role [of contingency counsel] should have his head examined."). Thus, "I would say with a measure of confidence that the [estates' assets] would be taken by the secured creditors [*i.e.*, respondents CIT and Sun Fund IV] in relatively short order following a conversion [to] Chapter 7 with nothing left over for stakeholders." Pet. App. 58a; *see also* Pet. App. 57-58a ("In the absence of *this*

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[2] A Chapter 11 liquidation plan was not a feasible option because the estate was administratively insolvent and all plans must pay administrative and priority claims in full on the plan's effective date. *See* 11 U.S.C. § 1129(a)(9).

settlement there is no realistic prospect" of "a meaningful distribution to unsecured creditors.") (emphasis added).

Given these findings, the bankruptcy court was "presented with two options": (1) "a meaningful return" for all unsecured creditors *except* petitioners under the settlement, or (2) "zero" for all unsecured creditors *including* petitioners in the absence of the settlement. Pet. App. 61a. Not surprisingly, after concluding that the Code's priority system applied only to plans, not settlements, Pet. App. 58a, the court chose the former option, Pet. App. 61a.

Petitioners did not challenge any of the bankruptcy court's factual findings as clearly erroneous in either the district court or the Third Circuit—just as they did not challenge any of those findings in their petition to this Court. *See* Pet. App. 40a (district court) ("[Petitioners] largely do not contest the bankruptcy court's factual findings."); Pet. App. 14-15a (Third Circuit) ("[Petitioners] mount no real challenge to the Bankruptcy Court's findings that there was no prospect of a confirmable plan in this case and that conversion to Chapter 7 was a bridge to nowhere."). So petitioners must now live with those findings, which obviously raise the question of what petitioners are doing here.

The Third Circuit honed in on this issue at oral argument below. The court asked petitioners' counsel "what is the remedy if ... you should prevail here, we go to Chapter 7; is that it?" Resps.' Supp. Br., Supp. App. 19a. Counsel responded "*Correct*, because that is the option that ... congress ...," before being interrupted by further questioning. *Id.* (emphasis added). The court then repeated the

question: "So you're not asking for any remedy from us other than it goes to Chapter 7?" *Id.* Counsel's answer was short and to the point: "Correct." *Id.*; *see also id.* at 60a (answering, in response to the question "what is the relief you are seeking here?," "Your Honors, we are simple folks, this case should go to a Chapter 7 trustee. We can't undo the fact that there isn't a nice landing for anyone there.").

The court then pressed counsel to explain how, in light of the bankruptcy court's uncontested findings, petitioners would benefit from conversion to Chapter 7. In that event, the court asked, any money remaining in the bankruptcy estates "goes to the secured creditors, right?" *Id.* at 21a. Counsel responded, "If that's the rules, then that is the rule, yes." *Id.* "And [petitioners] still get nothing?" *Id.* "Correct. If—if there's nothing left in the estate." *Id.*

These exchanges reveal that petitioners are not challenging the settlement of the fraudulent conveyance claim in the expectation of recovering a penny. Rather, petitioners are challenging the settlement because they (or at least their counsel) want an advisory opinion on what they view as the proper operation of the Bankruptcy Code, which they view as important in setting the baseline for negotiations in *other* bankruptcy cases.

Thus, petitioners insisted below that conversion to Chapter 7 would be a victory *regardless* of whether it yielded them any money (which, under the bankruptcy court's uncontested findings, it would not). According to their counsel, "if we undo the settlement and we go to Chapter 7, we're following the code." *Id.* at 19a. Regardless of whether they obtained any money, "[w]e think it's the better advice

to let the code do its job." *Id.* at 22a; *see also id.* at 55a ("We are prejudiced in every bankruptcy where we're told by the financiers, give up your WARN claims outside of this case or you're getting nothing in this bankruptcy. That is now ... the threat to us. And it's been used, base[d] on this case, and it will be used throughout the country."); *id.* at 60a (stating that petitioners are seeking "a stable rule, set of rules that people can count on and negotiate against in bankruptcy."). Counsel for the U.S. Trustee, appearing as *amicus* supporting petitioners below, made the same point: "We're not arguing that ... that the [bankruptcy court's] factual findings are clearly erroneous, what we're arguing is that where the code clearly ... prohibits what was done in this settlement," the settlement must be set aside. *Id.* at 33a.

The problem with this position is that, in the absence of "a proper case or controversy," the federal courts "have no business deciding [a dispute], or expounding the law in the course of doing so." *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332, 341 (2006). Thus, a long line of cases—culminating in *Steel Co.*—holds that a professed interest in vindicating federal law is insufficient to create an Article III "case" or "controversy." In *Steel Co.*, the Court held that it lacked jurisdiction to entertain a private entity's attempt to prove that a company had violated federal law and was thus liable for civil penalties. Such penalties would not personally benefit the plaintiff, the Court explained, because they would be payable to the United States Treasury. 523 U.S. at 106-07. This Court acknowledged that the plaintiff might derive "great comfort and joy from the fact that the United States Treasury is not

cheated, that a wrongdoer gets his just deserts, or that the Nation's laws are faithfully enforced." *Id.* at 107. But such "psychic satisfaction is not an acceptable Article III remedy because it does not redress a cognizable Article III injury." *Id.*; *see also Lujan v. Defenders of Wildlife*, 504 U.S. 555, 577 (1992); *Simon v. Eastern Ky. Welfare Rights Org.*, 426 U.S. 26, 38-44 (1976); *Linda R.S. v. Richard D.*, 410 U.S. 614, 618 (1973); *Fairchild v. Hughes*, 258 U.S. 126, 129-30 (1922).

Petitioners apparently now understand that they cannot admit that this case is no more than an effort to vindicate their view (or their counsel's view) of how the Bankruptcy Code should operate. So their brief speculates that they might or would have obtained a better settlement if the bankruptcy court had rejected this settlement. *See, e.g.*, Petrs.' Br. 4 ("[T]here is no way to know whether the parties would have settled had [respondents] been required to respect priority."); *id.* at 51 ("[I]t is highly implausible that Sun would have paid *nothing* to achieve the benefits it obtained through the settlement if the bankruptcy court had required that priority be respected.") (emphasis in original).

But that is just wishful thinking. As an initial matter, petitioners have specifically disavowed any interest in "reforming" the settlement, and insisted that their only requested remedy was conversion to a Chapter 7 liquidation. Resps.' Supp. Br., Supp. App. 19-20a, 60a. In any event, as noted above, the bankruptcy court found that no Chapter 11 plan or alternative settlement was feasible, so that the only option to this settlement was conversion to a Chapter 7 liquidation, in which case respondents CIT and

Sun Fund IV would have received all of the estates' assets in short order and unsecured creditors (including petitioners) would have recovered nothing, Pet. App. 56-61a, and petitioners have not challenged those findings.

Thus, as the Third Circuit explained, the notion that petitioners could have achieved a better settlement if the bankruptcy court had rejected this one "rests on [a] counterfactual premise." Pet. App. 21a; *see also id.* ("[T]here is no evidence calling into question the Bankruptcy Court's conclusion that there was 'no realistic prospect' of a meaningful distribution to Jevic's unsecured creditors apart from the settlement under review.") (quoting Pet. App. 58a). Both the district court and the Third Circuit credited the bankruptcy court's factual findings, and this Court should do likewise. This Court does not sit to review factual findings (especially where they have been ratified by two lower courts), *see, e.g.*, *Exxon Co., U.S.A. v. Sofec, Inc.*, 517 U.S. 830, 841 (1996); *Graver Tank & Mfg. Co. v. Linde Air Prods. Co.*, 336 U.S. 271, 275 (1949), and in any event petitioners have not even attempted to prove that those factual findings are clearly erroneous.

In a last-ditch effort to explain what they are doing here, petitioners suggest that if the settlement had been rejected, the Chapter 11 case might have been dismissed outright and they "would have been free to pursue" their own fraudulent conveyance claim against respondents CIT and Sun Fund IV in their capacity as Jevic creditors. Petrs.' Br. 17. That suggestion is unavailing.

As an initial matter, that suggestion runs counter to petitioners' position in this case up to now.

Petitioners have never previously suggested any interest in pursuing a fraudulent conveyance claim against CIT and Sun Fund IV, and never asked the bankruptcy court to dismiss the Chapter 11 case outright in order for them to do so. To the contrary, as noted above, they were repeatedly asked point-blank below what relief they were seeking and unequivocally answered conversion to a Chapter 7 liquidation. *See* Resps.' Supp. Br., Supp. App. 19-20a, 60a. Not until the certiorari stage in this Court did *anyone* advance the theory that rejecting the settlement could theoretically benefit petitioners by leaving them free to pursue their own fraudulent conveyance action—and even then that theory was advanced not by petitioners, but by their *amici*. *See* Law Profs.' Br. 11-13; U.S. Br. 17-18. Because petitioners never challenged the settlement below on this ground, they cannot advance it for the first time in this Court. *See, e.g.*, *OBB Personenverkehr AG v. Sachs*, 136 S. Ct. 390, 397-98 (2015).

Petitioners' failure to advance this theory below was no oversight, as it has no basis in reality. A major issue at the hearing on the settlement was whether a Chapter 7 trustee could locate anyone to pursue the estates' long-shot fraudulent conveyance claim. Petitioners never offered to do so, or to identify contingency counsel who would do so—a point on which the Third Circuit pressed petitioners' counsel repeatedly at the oral argument below, and in response to which they never suggested that they wanted (or had the resources) to pursue the fraudulent conveyance claim themselves or to obtain contingency counsel to do so. *See* Resps.' Supp. Br., Supp. App. 15a, 57a.

If, as the bankruptcy court found, contingency counsel would have to "have his head examined" to pursue that claim on behalf of the estates, Pet. App. 61a, that is true *a fortiori* with respect to pursuing that claim on behalf of petitioners. Both claims, after all, would face the same significant obstacles, *see* Pet. App. 60a, but the potential recovery on behalf of petitioners alone would be far smaller than the potential recovery on behalf of all unsecured creditors. (A claim on behalf of petitioners alone would be limited to the "amount necessary to satisfy" their individual "claim[s]," N.J. Stat. Ann. § 25:2-30(b); *see also id.* § 25:2-29(a)(1), whereas a claim on behalf of the bankruptcy estates could seek an amount necessary to satisfy the claims of *all* creditors.) Thus, petitioners' current suggestion that they might have pursued an individual fraudulent conveyance claim if the bankruptcy court had rejected the settlement—especially when petitioners themselves never raised that possibility in that court—is at best speculative. And a speculative theory cannot be the basis for establishing an Article III "case" or "controversy"; to the contrary, petitioners must prove that their alleged injury is "*likely* to be redressed by a favorable judicial decision." *Spokeo*, 136 S. Ct. at 1547 (emphasis added; internal quotation omitted).

The bottom line here is that petitioners do not like the settlement, but cannot overcome the bankruptcy court's factual findings that there was no feasible alternative that would have left them better off. Indeed, their challenge to the settlement threatens to harm all of the other unsecured creditors without helping petitioners. However important the question presented in the petition, "it is not as important as

observing the constitutional limits set upon courts in our system of separated powers." *Steel Co.*, 523 U.S. at 110. Accordingly, this Court should dismiss this case for lack of jurisdiction.

II. The Bankruptcy Code Neither Authorizes Nor Requires Bankruptcy Courts To Reject Chapter 11 Settlements That Do Not Follow The Code's Priority System.

Turning to the question on which this Court granted certiorari, nothing in the Bankruptcy Code requires bankruptcy courts to reject all Chapter 11 settlements that distribute proceeds "in a manner that violates the statutory priority scheme." Pet. i. Indeed, nothing in the Bankruptcy Code requires bankruptcy courts to review and approve Chapter 11 settlements in the first place. Because the latter question is logically antecedent to the former, *see, e.g.*, *Arcadia, Ohio v. Ohio Power Co.*, 498 U.S. 73, 77 (1990), and is "predicate to an intelligent resolution of the question presented," *Ohio v. Robinette*, 519 U.S. 33, 38 (1996) (internal quotation omitted), respondents will address it first.

A. The Bankruptcy Code Neither Authorizes Nor Requires Bankruptcy Courts To Review Or Approve Chapter 11 Settlements.

Petitioners' argument that bankruptcy courts must reject all Chapter 11 settlements that do not follow the Code's priority system rests on the premise that bankruptcy courts must review and approve such settlements in the first place. That premise is incorrect; nothing in the Bankruptcy Code either authorizes or requires bankruptcy courts to review or approve settlements.

As a threshold matter, this issue was not litigated below, because the Third Circuit has long held to the contrary. In *Martin*, that court held that "[u]nder Bankruptcy Rule 9019, a bankruptcy judge has the authority to approve a compromise of a claim," and articulated a series of factors for the court to consider in doing so. 91 F.3d at 393. The court purported to locate the statutory authority for that Rule in 11 U.S.C. § 363(b)(1), which provides:

> The trustee, after notice and a hearing, may [1] use, [2] sell, or [3] lease, other than in the ordinary course of business, property of the estate.

Id. at 394 (quoting 11 U.S.C. § 363(b)(1); emphasis omitted). Under this view, the settlement of a legal claim represents a "sale" of estate property (*i.e.*, the claim) outside the ordinary course of business. Thus, according to the court, "Section 363 of the Code is the substantive provision requiring a hearing and court approval; Bankruptcy Rule 9019 sets forth the procedure for approving an agreement to settle or compromise a controversy." *Id.* at 394 n.2. In the two decades that *Martin* has been on the books, it has been settled law in the Third Circuit that a Chapter 11 settlement requires a bankruptcy court's approval. *See, e.g.*, *Northview Motors*, 186 F.3d at 350-51 & nn.3,4; *In re Nutraquest, Inc.*, 434 F.3d 639, 644-45 (3d Cir. 2006).

On that foundational point, however, the Third Circuit is incorrect. Indeed, the First Circuit has concluded exactly the opposite, holding that the settlement of a claim is not a "sale" within the meaning of § 363, and thus there is nothing in the Bankruptcy Code that either requires or authorizes a

court to approve a settlement. *See In re Healthco Int'l, Inc.*, 136 F.3d 45, 49-50 & n.4 (1st Cir. 1998). Commentators have recognized this conflict among the circuits. *See, e.g.*, Peter J. Davis, *Settlements as Sales under the Bankruptcy Code*, 78 U. Chi. L. Rev. 999, 999 (2011) ("Circuit courts disagree over whether a settlement of a cause of action should be classified as a sale under § 363."). Petitioners simply gloss over this issue, asserting that "[t]he settlement of an estate cause of action is ..., in substance, a sale of estate property ... subject to the requirements of § 363," and citing the cases on the other side of the split. Petrs.' Br. 33 (citing *In re Moore*, 608 F.3d 253, 263-65 (5th Cir. 2010); *Northview*, 186 F.3d at 350-51 & n.4, and *Martin*, 91 F.3d at 394-95 & n.2).

Both the text and the history of the statute support the First Circuit's position. For starters, the settlement of a cause of action is not a "sale" of property. A "sale" involves the *transfer* of property for consideration. *See, e.g.*, *Webster's Third New Int'l Dictionary* 2003 (1976) (defining "sale" as "a contract transferring the absolute or general ownership of property from one person or corporate body to another for a price"); *Random House Dictionary of the English Language* 1693 (2d ed. 1987) (defining "sale" as a "transfer of property for money or credit"); *Black's Law Dictionary* 1537 (10th ed. 2014) (defining "sale" as "[t]he transfer of property or title for a price"). A settlement involves no such transfer. No one is purchasing a settled cause of action to pursue it; rather, it is being voluntarily extinguished for consideration. *See Healthco*, 136 F.3d at 49. If someone agreed to smash a vase for $100, one would hardly say that she thereby "sold" the vase to someone else.

The statutory history reinforces this straightforward point. The Nation's first permanent federal bankruptcy statute was the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544. That Act remained in place, subject to amendments, until 1978, when Congress repealed and replaced it with the current Bankruptcy Code. *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978); *Wellness Int'l Network, Ltd. v. Sharif*, 135 S. Ct. 1932, 1939 (2015).

The 1898 Act included a specific provision, Section 27, that authorized and required judicial reivew of Chapter 11 settlements:

> The receiver or trustee may, *with the approval of the court*, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate.

Bankruptcy Act of 1898 § 27, 30 Stat. at 553-54 (emphasis added), codified at 11 U.S.C. § 50, Supp. App. 1a (repealed). And Congress kept that requirement in place when, in 1938, it substantially amended the 1898 Act. *See* Act of June 22, 1938, Pub. L. No. 77-969 § 27, 52 Stat. 840, 855, codified at 11 U.S.C. § 50, Supp. App. 2a (repealed); *see generally* 1 *Collier on Bankruptcy* ¶ 20.01[i] (Alan N. Resnick ed. 2010 ed.).

When Congress replaced the 1898 Act with the current Bankruptcy Code in 1978, however, it did not enact a counterpart to Section 27. And that was no oversight: a major objective of the 1978 overhaul of bankruptcy law was to *curtail* judicial involvement in the day-to-day administration of the estate. Under the 1898 Act, district courts (sitting as

bankruptcy courts) or their referees exercised substantial control over bankruptcy trustees, and "every important determination in reorganization proceedings receive[d] the 'informed, independent judgment' of the bankruptcy court." *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968) (quoting *National Surety Co. v. Coriell*, 289 U.S. 426, 436 (1933)); *see also* H.R. Rep. No. 95-595, at 88-91 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6049-53.

The 1978 Act broke sharply from that model, and limited judicial control over the management of the estate to preserve the courts' impartiality. Congress thus replaced the prior system with specialized bankruptcy courts to act as "passive arbiters of disputes that arise in bankruptcy cases" rather than micromanagers. H.R. Rep. 95-595 at 107, 1978 U.S.C.C.A.N. at 6069; *see also id.* at 4, 91, 1978 U.S.C.C.A.N. at 5965-66, 6052-53; *see generally Northern Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 53 (1982). These changes significantly increased the autonomy of bankruptcy trustees by "remov[ing] many of the supervisory functions from the judge in the first instance, [and] transfer[ring] most of them to the trustee and to the United States Trustee." H.R. Rep. 95-595 at 4, 1978 U.S.C.C.A.N. at 5966; *see also id.* at 107, 1978 U.S.C.C.A.N. at 6069 ("More responsibility for the administration of cases will be shifted to the trustees that serve in cases.").

In this context, it is impossible to view the repeal of Section 27, without a replacement, as anything other than a decision to remove bankruptcy courts

from the business of reviewing and approving Chapter 11 settlements. When Congress repeals legislation, courts must "presume it intends [the change] to have a real and substantial effect." *Stone v. INS*, 514 U.S. 386, 397 (1995); *see also United States v. Quality Stores, Inc.*, 134 S. Ct. 1395, 1401 (2014). The Code now says *nothing* about judicial review or approval of settlements. And that is certainly not because settlements are rare; to the contrary, "it is an unusual case in which there is not some litigation that is settled between the representative of the estate and an adverse party." *Martin*, 91 F.3d at 393.

It is especially anomalous to suggest that Section 363 should now do the work previously performed by Section 27, because Section 363's precursor—Section 116(3) of the 1938 amendments to the 1898 Act, 11 U.S.C. § 516(3), Supp. App. 2-3a (repealed)—coexisted with Section 27 for forty years. If Section 116(3) authorized and required courts to approve bankruptcy settlements, Section 27 would have been superfluous for all of those years.

And because no provision of the Bankruptcy Code authorizes or requires bankruptcy courts to review and approve Chapter 11 settlements, no statutory standard governs such approval and review. The courts that have held or assumed that bankruptcy courts have such authority under the Code have simply "tak[en] [their] cue" from pre-Code caselaw based on Section 27, without pausing to consider the ongoing vitality of that caselaw. *See, e.g.*, *Martin*, 91 F.3d at 393 (crafting four-factor test based on *TMT Trailer Ferry*, 390 U.S. at 424-25); *Nutraquest*, 434 F.3d at 645 (relying on *TMT Trailer Ferry* and *Drexel*

v. Loomis, 35 F.3d 800, 806 (8th Cir. 1929)); *see generally* 10 *Collier on Bankruptcy* ¶ 9019.02 (collecting cases). Thus, the factors applied in reviewing bankruptcy settlements have no statutory mooring.

Nor does Federal Rule of Bankruptcy Procedure 9019 provide any such mooring. That Rule provides in relevant part that "[o]n motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement." Fed. R. Bankr. P. 9019(a). The Rule provides no substantive standard for approving a settlement, which is not surprising because it is merely a procedural rule promulgated by this Court under the Bankruptcy Rules Enabling Act, 28 U.S.C. § 2075. The Rule is based on former Bankruptcy Rule 919, which was the procedural counterpart to Section 27. *See, e.g.*, *Healthco*, 136 F.3d at 50 n.4. In other words, the substantive underpinning is gone, but the Rule lives on. *See*, *e.g.*, *Iridium*, 478 F.3d at 461 ("Bankruptcy Rule 9019 [is] unique in that it does not have a parallel section in the Code.").

In the absence of a parallel provision in the Code, of course, Rule 9019 cannot provide any substantive authority. *See* 28 U.S.C. § 2075 (Federal Rules of Bankruptcy Procedure "shall not abridge, enlarge, or modify any substantive right"). Indeed, petitioners themselves recognize that "Rule 9019, as a rule of procedure, cannot provide on its own [authority for settling an estate cause of action]," Petrs.' Br. 32, and simply purport to locate the source of such authority in Section 363, even though that Section has its own corresponding procedural rule, Federal

Rule of Bankruptcy Procedure 6004 ("Use, Sale, or Lease of Property").

Congress' decision not to require judicial approval of Chapter 11 settlements does not give parties *carte blanche* to use settlements to circumvent the Code's priority system. Rather, the Code includes other protections to ensure that creditors are not unfairly squeezed out of a recovery. A confirmed plan of reorganization is the goal in almost every Chapter 11 case, *see* 7 *Collier on Bankruptcy* ¶ 1129.01, and the plan itself must still comply with the Code's priority system and in particular the absolute priority rule of § 1129(b)(2)(B)(ii). A settlement that distributes estate assets in a way that harms a priority creditor will make that difficult if not impossible.

Even without judicial review, then, settlements that do not follow the Code's priority system will be reserved for those rare circumstances where, as here, the settlement leaves a passed-over creditor no worse off than the available alternatives and improves the lot of all other unsecured creditors. And if such settlements are deemed to be a problem, Congress may at any time amend the Code to restore the judicial authority and responsibility to review settlements that it repealed in 1978. Meanwhile, courts may not pretend that the repeal never happened and continue reviewing Chapter 11 settlements as they did before 1978.

B. The Bankruptcy Code's Priority System Does Not Apply To Chapter 11 Settlements.

Even if bankruptcy court review and approval of Chapter 11 settlements is required, nothing prevents those courts from "authoriz[ing] the distribution of

settlement proceeds in a manner that violates the statutory priority scheme." Pet. i. The Code's priority system does not apply to Chapter 11 settlements, and petitioners' contrary policy arguments are irrelevant and unavailing.

1. Nothing In The Bankruptcy Code Applies The Priority System To Chapter 11 Settlements.

Nothing in the Code's text extends the Code's priority system to Chapter 11 settlements, as opposed to Chapter 11 plans. The absolute priority rule, as this Court has recognized, is "now on the books as subsection (b)(2)(B)(ii)"—*i.e.*, 11 U.S.C. § 1129(b)(2)(B)(ii). *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 449 (1999). Under that rule, creditors are divided into classes according to the priority of their claims, and the claims of rejecting senior classes must be paid before the claims of junior classes:

> [T]he conditions that a *plan* be fair and equitable with respect to a class includes the following requirements … With respect to a class of unsecured claims … the holder of any claim or interest that is junior to the claims of such class will not receive or retain *under the plan* on account of such junior claim or interest any property.

11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added); *see also id.* § 1129(a)(8); *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988). By its plain terms, the rule only applies to a "plan"—and then only to dissenting classes of claims under a plan (not to consenting classes under a plan nor to dissenting

members of consenting classes under a plan). Indeed, Section 1129, in which the rule is codified, is entitled "Confirmation of *plan*" and describes the "requirements" for a court to "confirm a *plan*." 11 U.S.C. § 1129(a) (emphasis added). That is the beginning and the end of the matter: if Congress had wanted the Code's priority system to apply to Chapter 11 settlements as well as Chapter 11 plans, it could and would have said so.

In arguing to the contrary in their petition, petitioners relied on the Fifth Circuit's 1984 decision in *AWECO*. In particular, they seized upon a sentence in *AWECO* in which the Fifth Circuit declared that "'a bankruptcy court abuses its discretion in approving a settlement with a junior creditor unless the court concludes that priority of payment will be respected as to objecting senior creditors.'" Pet. 16 (quoting *AWECO*, 725 F.2d at 298). According to the petition, "there is a square and acknowledged split among the circuits on the question presented," *id.* at 15 (capitalization modified), because *AWECO* "adopted a per se rule under which any distribution of settlement proceeds" must follow the Code's priority system, while the Second Circuit in *Iridium* and the Third Circuit in this case held that Chapter 11 settlements were not governed by the Code's priority system, *id.* at 15-16.

In their merits brief, however, petitioners make no pretense of defending the *AWECO* rule. Indeed, that case appears only once in the argument section of that brief, and then only in a footnote seeking to *distinguish* the case on the ground that "the relevant consideration is not whether the bankruptcy court is approving a settlement." Petrs.' Br. 32 n.6.

It is no surprise that petitioners do not wish to defend the *AWECO* rule on which they relied in their petition (and which was the subject of the alleged circuit split that this Court granted certiorari to review), because that rule is indefensible. The Fifth Circuit did not purport to derive the rule from the statute. Rather, the *AWECO* court "f[ou]nd the *policy arguments* convincing that some extension of the fair and equitable standard [into the realm of Chapter 11 settlements] is proper." 725 F.2d at 298 (emphasis added); *see also id.* ("Our understanding of bankruptcy law's *underlying policies* leads us to make a limited extension of the fair and equitable standard.") (emphasis added); *id.* (approving Chapter 11 settlement that does not follow priority system "contravenes a basic notion of fairness").

Because "a goal" of Chapter 11 is approval of a plan, the Fifth Circuit asserted, that goal should exist throughout a Chapter 11 proceeding; it "does not suddenly appear during the process of approving a plan." *Id.* But that assertion is illogical: just because a Chapter 11 plan must follow the Code's priority system as to dissenting classes of creditors does not mean that every pre-plan component of a Chapter 11 proceeding must follow that priority system. The Fifth Circuit thus missed the point by declaring that "if the [priority system] had no application before confirmation of a reorganization plan, then bankruptcy courts would have the discretion to favor junior classes of creditors so long as the approval of the settlement came before the plan." *Id.* As long as the *plan* follows the priority system, it is immaterial if every individual step on the path to the plan follows the priority system.

The Second Circuit in *Iridium* was, if anything, polite in characterizing the *AWECO* rule as "too rigid." 478 F.3d at 464. The *Iridium* court recognized, with some understatement, that "[w]hen a settlement is presented for court approval apart from a reorganization plan ... the priority rule of 11 U.S.C. § 1129 is not necessarily implicated." *Id.* at 463. The court thus held that a Chapter 11 settlement need not follow the Code's priority system. Still, the court identified "a heightened risk that the parties to a settlement may engage in improper collusion," and thus characterized compliance with the priority system as "the most important factor for the bankruptcy court to consider" in reviewing a Chapter 11 settlement. *Id.* at 464; *see also id.* ("The court must be certain that parties to a settlement have not employed a settlement as a means to avoid the priority strictures of the Bankruptcy Code."). The Third Circuit in this case adopted that standard—without objection from petitioners and without dissent. *See* Pet. App. 19a, 24a.

Petitioners, however, now ask this Court to reject that standard, and hold that a Chapter 11 settlement must follow the Code's priority system. They make no pretense that this position has any basis in the Code's text. To the contrary, they argue that it is "irrelevant" that "nothing in the Code in so many words requires compliance with the priority scheme when a bankruptcy court approves a settlement of estate litigation." Petrs.' Br. 22. Rather, they assert, "[t]he Code cannot sensibly be read" to allow Chapter 11 settlements that do not follow the Code's priority system, and to do so would "fail[] to honor th[e] basic precept" that statutory provisions must be

understood in context. Petrs.' Br. 22-23, 41. In essence, they contend, a requirement that a Chapter 11 settlement must follow the Code's priority system is to be found in the Code's penumbras, emanating from the general policies underlying specific Code provisions.

That is simply not the way this Court interprets statutes, particularly not statutes as "'meticulous' and 'detailed'" as the Bankruptcy Code. Petrs.' Br. 21 (quoting *Law v. Siegel*, 134 S. Ct. 1188, 1196 (2014)). Petitioners are not asking this Court to interpret any particular statutory term in context, but instead to invent a new statutory requirement.

Petitioners' *amicus* the United States at least refrains from asking the Court to impose a statutory requirement with no basis in the statute. Thus, the United States argues that the Code's priority system, set forth in 11 U.S.C. § 507, governs Chapter 11 settlements by virtue of 11 U.S.C. § 103(a). *See* U.S. Br. 3, 13, 18, 24, 26. That argument is based on the following syllogism: (1) the Code's priority system is set forth in § 507, which is part of Chapter 5, (2) Section 103(a) states in relevant part that Chapter 5 applies in a case under Chapter 11, so therefore (3) the Code's priority system applies to a settlement in a case under Chapter 11. *See id.*

As the Third Circuit explained, that syllogism is flawed. Pet. App. 15-17a & n.7. Section 507 describes the priority of particular unsecured "expenses and claims," but does not specify the circumstances under which bankruptcy courts are required to apply those priorities. 11 U.S.C. § 507. That is why Congress specified that the priorities set forth in § 507 apply to dissenting classes of creditors

under plans, *see id.* § 1129(b)(2)(B)(ii), and to the payment of unsecured claims in a Chapter 7 liquidation, *see id.* § 726(a) ("[P]roperty of the estate shall be distributed … first, in payment of claims of the kind specified in, and in the ordered specified in, section 507 of this title …"). Section 507 does not, of its own force, impose its priority system upon plans (or anything else).

Nor does Section 103(a) do the job. That provision generally provides that "chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title," 11 U.S.C. § 103(a), without specifically addressing to *what* in the latter chapters the former chapters apply. Again, that is why, when Congress wanted to specify that Chapter 11 plans and Chapter 7 liquidations must follow the § 507 priority system, it said so in Chapter 11, *see* 11 U.S.C. §§ 1129(a)(9), (b)(2)(B)(ii), and in Chapter 7, *see* 11 U.S.C. § 726. If Section 103(a) means that a Chapter 11 settlement must follow the Code's priority system, "there would have been no need for Congress to codify the absolute priority rule specifically in the plan confirmation context." Pet. App. 16a n.7.

Petitioners' invocation of the canon that "'the specific governs the general'" is thus inexplicable. Petrs.' Br. 38 (quoting *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992)). The "specific provisions governing distribution of estate assets" to which petitioners point over and over again in their brief—11 U.S.C. §§ 726 and 1129—do not mention settlements. Petrs.' Br. 38. That simple point distinguishes *United Savings Ass'n of Tex. v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 373 (1988), where a creditor attempted to use broad

language from the Code's general provisions to circumvent the Code's "carefully drawn" limits on a specific issue (the types of creditors who could seek post-petition interest). If anything, the canon that the specific governs the general *refutes* petitioners' argument here, given that they are relying on the Code's general priority system to circumvent the specific provision of Chapter 11 applying that system to plans, not settlements.

The absence of any provision applying the Code's priority system to Chapter 11 settlements likewise distinguishes *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065 (2012). The debtors there tried to use broad language in the Code to circumvent a specific requirement. *Id.* at 2070. Allowing settlements that do not follow the Code's priority system in limited circumstances, in contrast, would not circumvent any provision of the Code for the simple reason that no provision of the Code applies the priority system to settlements.

At bottom, petitioners thus frame the issue precisely backwards by complaining that the Third Circuit "failed to cite any provision of the Code permitting … a departure" from the Code's priority system. Petrs.' Br. 32. The key point here is that *petitioners* have failed to cite any provision of the Code applying the priority system to Chapter 11 settlements in the first place. As the Third Circuit recognized, and petitioners largely concede, the Code by its plain terms does not extend that priority system to Chapter 11 settlements. If petitioners do not like that result, they are of course free to ask Congress to amend the Code.

2. There Is No "Common Law" Basis For Applying The Bankruptcy Code's Priority System To Chapter 11 Settlements.

Acknowledging that nothing in the Code applies the priority system to Chapter 11 settlements, some of petitioners' *amici* argue that "the absolute priority rule applies to settlements as a matter of common law, not statute." Law Profs.' Br. 12 n.10 (citing *TMT Trailer Ferry*, 390 U.S. at 432); *see also* Petrs.' Br. 31-32 & n.6 (relying on *TMT Trailer Ferry*). That argument is meritless. Congress has enacted a comprehensive and detailed statute, the Bankruptcy Code, to govern bankruptcy cases, and courts thus must work "within the confines" of that statute. *Law*, 134 S. Ct. at 1194. Thus, courts cannot "take it upon themselves" to invent common-law rules to address any perceived shortcomings in the Code. *United States v. Noland*, 517 U.S. 535, 543 (1996); *see also Raleigh v. Illinois Dep't of Revenue*, 530 U.S. 15, 24-25 (2000) ("Bankruptcy courts … are limited to what the Bankruptcy Code itself provides.").

In any event, the common-law rule that petitioners and their *amici* purport to derive from *TMT Trailer Ferry* never existed and certainly does not exist today. *TMT Trailer Ferry*, according to petitioners, holds that a settlement "must be 'fair and equitable' to all creditors" and treated that phrase as "a term of art incorporating 'the absolute priority doctrine.'" Petrs.' Br. 32 n.6 (quoting *TMT Trailer Ferry*, 390 U.S. at 424, 441)); *see also* Illinois Br. 20-21.

As an initial matter, *TMT Trailer Ferry* was decided under the 1898 Bankruptcy Act, not the 1978 Bankruptcy Code, and proceeded from the premise,

rejected in the Code, that "it is essential that every important determination in reorganization proceedings," including settlements, "receive the 'informed, independent judgment' of the bankruptcy court." 390 U.S. at 424 (quoting *Coriell*, 289 U.S. at 436). *TMT Trailer Ferry* did not purport to announce any general rules of federal common law, but instead to interpret and apply specific provisions of the 1898 Act.

In any event, petitioners' description of *TMT Trailer Ferry* fails on its own terms. This Court there used the phrase "fair and equitable" in two different contexts, and in each context ascribed a different meaning to that term. Petitioners and their *amici* conflate the two, as underscored by their quotation of two separate passages separated by almost twenty pages of text.

TMT Trailer Ferry first held that, under the 1898 Act, a bankruptcy court must "determine that a proposed compromise forming part of a reorganization plan is fair and equitable," and that this inquiry requires the judge to "compare the terms of the compromise with the likely rewards of the litigation." *TMT Trailer Ferry*, 390 U.S. at 424-25. The Court then held that the bankruptcy court in that case had not, before approving the settlement, "adequate[ly] and intelligent[ly]" considered the merits of the settled claims, "the difficulties of pursuing them," and "the fairness of the terms of the settlement." *Id.* at 434. When discussing the propriety of the settlement, not once did the Court allude to the absolute priority rule.

Seventeen pages after announcing a "fair and equitable" standard for settlements incorporated into

a plan of reorganization, *see id.* at 424, this Court turned to the merits of the proposed plan of reorganization itself, *see id.* at 441-53. And it was in *this* context that the Court separately stated that courts could not confirm a proposed plan "unless it is found to be 'fair and equitable,'" a standard that in the plan context "incorporates the absolute priority doctrine." *Id.* at 441. (And even then, none of the flaws this Court identified in the plan had anything to do with the absolute priority rule. *See id.* at 441-53.) The Court thus added the absolute priority rule as a gloss on the term "fair and equitable" *only* in the plan confirmation context. Accordingly, nothing in *TMT Trailer Ferry* stands for the proposition that a Chapter 11 settlement must comply with the Code's priority system outside the context of plan confirmation, and certainly not as a matter of "common law" divorced from the Code.

3. Petitioners' Policy Arguments Are Misguided.

Finally, petitioners and their *amici* argue at length that allowing settlements that do not follow the Code's priority system is bad policy. *See, e.g.*, Petrs.' Br. 45-46, 49-55; Br. of Loan Syndications & Trading Ass'n (LSTA) 3-17; Br. of National Employment Law Project (NELP) *et al.* 12-14; Law Profs.' Br. 24-27; Illinois Br. 26-29. The short answer is that these policy arguments "are for the consideration of Congress, not the courts." *RadLAX*, 132 S. Ct. at 2073.

In any event, petitioners' policy arguments fail on their own terms. As recognized by the Second Circuit in *Iridium* and the Third Circuit here, *AWECO*'s *per se* rule that Chapter 11 settlements

must follow the Code's priority system "cannot accommodate the dynamic status of some pre-plan bankruptcy settlements." *Iridium*, 478 F.3d at 464; *see also* Pet. App. 19-20a. This is a case in point. Petitioners' objection to the settlement would have left *all* unsecured creditors (including petitioners) worse off, because *no one* (including petitioners) was willing to continue pursuing the fraudulent conveyance claim, and a Chapter 7 liquidation would have put all of the estates' money in the pockets of secured creditors CIT and Sun Fund IV. By rejecting petitioners' objection, the bankruptcy court thus allowed over 1,000 unsecured creditors (including administrative and priority creditors like federal and state taxing authorities), who would have recovered *nothing* if petitioners had prevailed, to receive full or partial payment of their claims. *See* Pet. App. 39a.[3] Petitioners chose to "hold out" on the settlement in the hope that they would receive full compensation for their WARN claims against SCPI—a hope that all other participants recognized as unrealistic, and

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[3] It is an open question, moreover, whether these unsecured creditors could be forced at this late date (more than three years after they received their share of the settlement proceeds) to disgorge those proceeds. Respondents argued below that, wholly apart from the merits, these appeals are equitably moot in light of the substantial consummation of the settlement. *See, e.g.*, *Nordhoff Invs., Inc. v. Zenith Elecs. Corp.*, 258 F.3d 180, 185 (3d Cir. 2001); *In re Chateaugay Corp.*, 988 F.2d 322, 325 (2d Cir. 1993). Because the Third Circuit affirmed the bankruptcy court on the merits, it did not reach that issue. Accordingly, if petitioners were to prevail in this Court, the case would have to be remanded for the Third Circuit to address the equitable mootness argument in the first instance.

which later proved to be unrealistic when the courts dismissed petitioners' WARN claims against SCPI.

Given the dynamic nature of a bankruptcy case up until plan confirmation, it makes sense for the Bankruptcy Code to leave bankruptcy courts more flexibility when approving Chapter 11 settlements than when confirming Chapter 11 plans. As the Second Circuit explained in *Iridium*, it is difficult if not impossible to apply the priority system to a proposed settlement "when the nature and extent of the Estate and the claims against it are not yet fully resolved." 478 F.3d at 464. A flexible standard better accounts for these difficulties than *AWECO*'s *per se* rule.

Indeed, measuring each and every proposed settlement against the Code's priority system, as petitioners advocate, makes little sense. The priority system exists to ensure that a Chapter 11 plan or Chapter 7 liquidation *as a whole* fairly and equitably distributes a debtor's assets to its creditors. Insisting that each individual settlement and its proposed distribution of assets satisfies that same standard when considered in isolation does not further that interest. A particular settlement that does not follow the Code's priority system can be offset by other components of a plan.

To say that the Code's priority system does not apply of its own force to Chapter 11 settlements, of course, is not to say that the Code's priority system is *irrelevant* to settlements. To the contrary, the Third Circuit "agree[d] with the Second Circuit's statement that compliance with the Code priorities *will usually be dispositive* of whether a proposed settlement" is acceptable. Pet. App. 20a (emphasis added; citing

Iridium, 478 F.3d at 455). In doing so, the Third Circuit held "bankruptcy courts may approve settlements that deviate from the priority scheme of § 507 of the Bankruptcy Code *only* if they have 'specific and credible grounds' to justify [the] deviation," and observed that such deviations are "likely to be justified only rarely." *Id.* at 21a, 23a (brackets in original); *see also id.* at 2a (holding courts should approve settlements that do not follow the Code's priority system only in a "rare case"). Thus, the Third Circuit held that the bankruptcy court here acted within its discretion in approving this settlement *only* because the court had made detailed factual findings that "there was 'no realistic prospect' of a meaningful distribution to anyone but the secured creditors unless the settlement were approved because the traditional routes out of Chapter 11 bankruptcy were impracticable." *Id.* at 8a; *see also id.* at 4-9a, 21-23a.

Petitioners and their *amici* predict that limiting priority-skipping settlements to rare cases will prove unworkable because it "is simply not clear as to what should trigger similar deviations in the future." Law Profs.' Br. 22; *see also id.* at 2; Petrs.' Br. 52. That is simply not true. The Third Circuit announced two specific limitations on a bankruptcy court's authority in this context. Courts cannot approve Chapter 11 settlements that do not follow the Code's priority system (1) "when they are used to circumvent the plan confirmation process or conversion to Chapter 7," Pet. App. 14a, or (2) if they increase the "share[] of the estate" distributed to one group of creditors "at the expense of other creditors," Pet. App. 20-21a. These restrictions sharply limit the universe of permissible settlements that do not follow the Code's

priority system to "rare" cases like this one. Pet. App. 2a, 12a.

Here, as the Third Circuit recognized, both of these limitations were satisfied. The settlement was not an attempt to circumvent the requirements for confirming a Chapter 11 plan, because no such plan was feasible. *See* Pet. App. 21a. And the settlement could not be said to have allocated funds to junior creditors at petitioners' "expense" in light of the bankruptcy court's undisputed findings that the only relief petitioners requested (conversion to a Chapter 7 liquidation) would have left all the other unsecured creditors worse off while leaving petitioners no better off. *Id.* "This disposition, unsatisfying as it was, remained the least bad alternative." *Id.*

Petitioners and their *amici* insist that bankruptcy courts must reject even settlements that maximize value for creditors to prevent such courts from blessing collusive settlements. *See* Petrs.' Br. 53-55; *see also* Illinois Br. 24, 27; NELP Br. 18-22; Law Profs.' Br. 22, 24-25. As the Third Circuit explained in rejecting that argument, "[w]e doubt that our national bankruptcy policy is quite so nihilistic and distrustful of bankruptcy judges." Pet. App. 23a. Bankruptcy courts, subject to review by Article III courts, are certainly capable of determining whether a Chapter 11 settlement represents an impermissible attempt to circumvent the requirements for confirming a Chapter 11 plan or for improperly evading the Code's priority system.

Similarly unavailing is the States' concern that allowing Chapter 11 settlements that do not follow the Code's priority system will open the floodgates to settlements that skip tax-related priorities, *see*

Illinois Br. 27, even though the settlement here resulted in a recovery for priority tax creditors who otherwise would have recovered nothing, *see* Pet. App. 39a. It is hard to imagine any "specific and credible grounds," Pet. App. 21a, that would justify distributing assets to more junior creditors at the expense of priority tax creditors.

Petitioners thus present this Court with a false dichotomy: either a Chapter 11 settlement must invariably follow the Code's priority system, or a Chapter 11 settlement is subject to no limitations at all. *See* Petrs.' Br. 47. That argument fails to appreciate the need for flexibility in Chapter 11 settlements—a need so pressing that, as noted above, Congress repealed the provision authorizing judicial review of Chapter 11 settlements altogether.

Petitioners and their *amici* ultimately fall back on the argument that "a firm and certain priority rule," NELP Br. 22, is "the foundation of the bankruptcy system," Law Profs.' Br. 1; *see also* Petrs.' Br. 52-53. But that argument is based on an idealized version of the absolute priority rule that bears scant resemblance to reality. In fact, the absolute priority rule is neither absolute nor a rule; it is (and always has been) riddled with "widespread" exceptions that are "core to the normal science of corporate reorganizations." Mark J. Roe & Frederick Tung, *Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain*, 99 Va. L. Rev. 1235, 1240, 1250-64, 1280-87 (2013); *see also* Stephen J. Lubben, *The Overstated Absolute Priority Rule*, 21 Fordham J. of Corp. & Fin. L. 581, 583-84 (2016); Edward H. Levi & James Wm. Moore, *Bankruptcy & Reorganization: A Survey of Changes, III*, 5 U. Chi.

L. Rev. 398, 408 (1938) ("The absolute theory of priority … is entirely unrealistic in the reorganization of a large company.").

As just one example, courts routinely approve the payment of pre-petition wages to employees at the outset of a case. *See*, *e.g.*, *Cybergenics*, 330 F.3d at 574 n.8. Those employees thereby jump ahead of administrative creditors, other priority creditors, and even secured creditors in a case (like this one) where the debtor is worth less than the secured creditor is owed. *See* Lubben, *The Overstated Absolute Priority Rule*, 21 Fordham J. of Corp. & Fin. L. at 597; Douglas G. Baird, *Elements of Bankruptcy Law* 233 (6th ed. 2014). Petitioners and their *amici* thus have it exactly backwards by arguing that allowing settlements that do not follow the Code's priority system would harm "employees with unpaid wages and benefits." NELP Br. 1, 18-19; *see also* Petrs.' Br. 45-47. Petitioners received millions of dollars in unpaid wages and benefits from the debtors' estates, even though they were unsecured creditors who, under a strict application of the priority rule, would not be entitled to a penny unless and until secured creditors like respondents CIT and Sun Fund IV and all administrative creditors were paid in full. *See* JA206, 226-27. Petitioners, in short, should be careful what they wish for, because the legal regime they propose would leave them much worse off.

And the payment of employees' pre-petition wages is not the only way in which courts routinely deviate from the Code's priority system outside the plan context. Like employees, so-called "critical vendors" whose goods or services are essential to a debtor's post-petition success not infrequently receive

payments for their pre-petition invoices. *See*, *e.g.*, Lubben, *The Overstated Absolute Priority Rule*, 21 Fordham J. of Corp. & Fin. L. at 596; Baird, *Elements of Bankruptcy*, at 233-34. And yet other creditors move to the front of the line by "rolling up" their unsecured or undersecured pre-petition debt into post-petition debtor-in-possession loans that must be repaid before *any* pre-petition debt. *See* Roe & Tung, *Breaking Bankruptcy Priority*, 99 Va. L. Rev. at 1250-51; *see also* 11 U.S.C. §§ 364, 1129(a)(9). Petitioners thus not only overstate the "certainty" that the Code's priority system provides, Petrs.' Br. 52, but propose a far-reaching and atextual expansion of the Code's priority system that could significantly destabilize many "central features of modern bankruptcy practice," Roe & Tung, *Breaking Bankruptcy Priority*, 99 Va. L. Rev. at 1243.

Similarly unavailing (although revealing) is petitioners' complaint that the decision below will reduce creditors' "leverage" in future negotiations because "[t]he background threat" of a settlement that does not follow the Code's priority system "will hang over the parties' bargaining." Petrs.' Br. 53. That is what this case is really about: creditors' concern about preserving their bargaining "leverage" in *other* cases. But, as a policy matter, the "leverage" argument cuts precisely the other way: as this case illustrates, petitioners' *per se* rule would give the creditors *all* the leverage, and would allow a single holdout creditor to block a settlement that would benefit the debtors and other creditors by demanding payment in full even where that would destroy any hope of maximizing value to *all* creditors.

Even in the plan context, creditors do not enjoy the degree of leverage petitioners seek here. The Code's class voting rules for plans prevent a minority of holdout creditors from exercising a veto over a plan that even most similarly situated creditors support. *See* 11 U.S.C. §§ 1126(c) (deeming an entire class of creditors to accept their treatment under a proposed plan despite the objection of some class members if the plan has sufficiently broad support within the class); 1129(a)(8)(A) (a class of creditors, not each individual member of that class, must accept a plan). Petitioners, in contrast, would allow a single holdout WARN claimant to scuttle a Chapter 11 settlement even if all other creditors *and even all other WARN claimants* supported the deal. This highlights the folly of petitioners' *per se* rule and the danger of importing *only one aspect* of the Code's carefully calibrated plan confirmation process into the settlement context.

III. Whether The Bankruptcy Code Authorizes "Structured Dismissals" Of Chapter 11 Cases Is Not Properly Presented Here.

Presumably because petitioners understand that they cannot defend their side of the circuit conflict that they petitioned this Court to resolve, they now try to change the subject. Literally. They asked this Court to review this case to resolve an alleged circuit conflict between the Fifth Circuit in *AWECO*, on the one hand, and the Second Circuit in *Iridium* and the Third Circuit in this case, on the other, on the question whether Chapter 11 settlements (as opposed to plans) must follow the Code's priority scheme. *See* Pet. 15 ("There is a square and

acknowledged split among the circuits on the question presented.") (capitalization modified).

Petitioners have now changed the question presented to replace a question about judicial approval of Chapter 11 settlements with a question about termination of Chapter 11 cases through "structured dismissals." *Compare* Pet. i ("Whether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme.") (emphasis added) *with* Petrs.' Br. i ("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.").

That is a manifest violation of this Court's Rules. In particular, the Rules specify that "[t]he phrasing of the questions presented [in the merits briefs] need not be identical with that in the petition for a writ of certiorari or the jurisdictional statement, but the brief may not raise additional questions or *change the substance of the questions* already presented in those documents." U.S. S. Ct. R. 24.1(a) (emphasis added); *see also* U.S. S. Ct. R. 14(a) ("Only the questions set out in the petition, or fairly included therein, will be considered by the Court.").

There can be no doubt that petitioners are seeking to "change the substance" of the question presented in their petition, on which this Court granted review. As noted above, the petition asked this Court to resolve the alleged conflict between the Fifth Circuit's decision in *AWECO*, on the one hand, and the Second Circuit's decision in *Iridium* and the Third Circuit's decision in this case, on the other. But neither *AWECO* nor *Iridium* involved a

structured dismissal, so the validity of a structured dismissal cannot be said to be logically antecedent to or fairly included in the question presented. Not every distribution of an estate's property outside the context of a plan will necessarily entail a structured dismissal (or a settlement); to the contrary, petitioners themselves benefited from distributions of the estate's assets that did not involve a plan or a settlement (and did not follow the Code's priority system) when they received millions of dollars from the estate as compensation for pre-petition wages and benefits. *See* JA206, 226-27.

Indeed, respondents pointed out in their brief in opposition that "[t]he petition ... does not present the question whether the Bankruptcy Code permits structured dismissals under Chapter 11." Br. in Opp. 23 n.4 (citing Pet. i); *see also* Resps.' Supp. Br. 3 n.1. Petitioners did not dispute that point in their reply brief, but instead doubled down on their argument that this Court's review was warranted because "the courts of appeals are openly divided" on the question whether a Chapter 11 settlement must follow the Code's priority system. Reply to Br. in Opp. 3 (capitalization modified).

There is no mystery what is going on here: petitioners sought this Court's review based on an alleged circuit conflict on Issue "A," but once review was granted, Issue A went out the window and was replaced by Issue "B." This Court should not tolerate such transparent "bait-and-switch tactics." *City & County of San Francisco v. Sheehan*, 135 S. Ct. 1765, 1779 (2015) (Scalia, J., joined by Kagan, J., concurring in part and dissenting in part); *see generally Norfolk S. Ry. v. Sorrell*, 549 U.S. 158, 163-

64 (2007); *Yee v. City of Escondido*, 503 U.S. 519, 534-38 (1992).

It is implausible that this Court would have taken this case to review the validity of structured dismissals, which has only been addressed by a *single* federal court of appeals—the Third Circuit in the decision below. *See* Pet. App. 12-15a. As that court explained, the Bankruptcy Code "explicitly authorizes the bankruptcy court to alter the effect of dismissal 'for cause'—in other words, the Code does not strictly require dismissal of a Chapter 11 case to be a hard reset." Pet. App. 14a (citing 11 U.S.C. § 349(b)); *see also* 11 U.S.C. § 1112(b). And the Third Circuit did not broadly bless the use of structured dismissals; to the contrary, that court held only that the bankruptcy court did not abuse its discretion by dismissing this particular case "for cause" under § 349(b), given the absence of "a showing that [the] structured dismissal has been contrived to evade the procedural protections and safeguards of the plan confirmation or conversion processes." Pet. App. 15a.

There is no disagreement among the courts of appeals on this issue, and this Court does not ordinarily grant review to address a novel and far-reaching issue of federal law that has not first percolated among the federal courts of appeals. Because petitioners "induce[d] [this Court] to grant certiorari," *Sheehan*, 135 S. Ct. at 1779 (Scalia, J., joined by Kagan, J., concurring in part and dissenting in part), by focusing on an alleged circuit split on the question whether bankruptcy courts must reject Chapter 11 settlements that do not follow the Code's priority system, that question (or the logically antecedent question whether

bankruptcy courts must review Chapter 11 settlements at all) is all that this Court should address if it reaches the merits here.

CONCLUSION

For the foregoing reasons, this Court should dismiss for lack of jurisdiction or, in the alternative, affirm the judgment.

October 12, 2016

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SUPPLEMENTAL APPENDIX

SUPPLEMENTAL APPENDIX CONTENTS

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52 Stat. 840 (1938) (excerpts) 2a

Bankruptcy Act of 1898
55th Cong., 2d Sess.,
30 Stat. 544 (1898)

CHAP. 541—An Act to establish a uniform system of bankruptcy throughout the United States.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

* * *

CHAPTER IV

COURTS AND PROCEDURE THEREIN

* * *

SEC. 27. COMPROMISES.—The trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interests of the estate.

Act of June 22, 1938
75th Cong., 3rd Sess.,
52 Stat. 840 (1938)

AN ACT

To amend an Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States," approved July 1, 1898, and Acts amendatory thereof and supplementary thereto; and to repeal section 76 thereof and all Acts and parts of Acts inconsistent therewith.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That sections 1 to 11, inclusive; 14; 15; 17 to 29, inclusive; 31; 32; 34; 35; 37 to 42, inclusive; 44 to 53, inclusive; and 55 to 72, inclusive, of an Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States," approved July 1, 1989, as amended, are hereby amended; and sections 12, 13, 73, 74, 77A, and 77B are hereby amended and incorporated as chapters X, XI, XII, XIII, and XIV; said amended sections to read as follows:

* * *

CHAPTER IV—COURTS AND PROCEDURE THEREIN

* * *

"SEC. 27. COMPROMISES.—The receiver or trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate.

* * *

CHAPTER X—CORPORATE REORGANIZATIONS

*   *   *

"ARTICLE III—JURISDICTION AND POWERS OF COURT

*   *   *

"SEC. 116. Upon the approval of a petition, the judge may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon him and the court—

"(1) permit the rejection of executory contracts of the debtor, except contracts in the public authority, upon notice of the parties to such contracts and to such other parties in interest as the judge may designate;

"(2) authorize a receiver, trustee, or debtor in possession, upon such notice as the judge may prescribe and upon cause shown, to issue certificates of indebtedness for cash, property, or other consideration approved by the judge, upon such terms and conditions and with such security and priority in payment over existing obligations, secured or unsecured, as in the particular case may be equitable;

"(3) authorize a receiver or a trustee or a debtor in possession, upon such notice as the judge may prescribe and upon cause shown, to lease or sell any property of the debtor, whether real or personal, upon such terms and conditions as the judge may approved; and

"(4) in addition to the relief provided by section 11 of this Act, enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor.

No. 15-649

In the Supreme Court of the United States

CASIMIR CZYZEWSKI, ET AL., PETITIONERS

v.

JEVIC HOLDING CORP., ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether a bankruptcy court may authorize a distribution of settlement proceeds that violates the priority scheme established by the Bankruptcy Code, over the objection of priority creditors whose rights are impaired by the proposed distribution.

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In the Supreme Court of the United States

No. 15-649

CASIMIR CZYZEWSKI, ET AL., PETITIONERS

v.

JEVIC HOLDING CORP., ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

INTEREST OF THE UNITED STATES

This case presents the question whether a bankruptcy court may authorize a distribution of settlement proceeds in a manner that violates the priority scheme established in the Bankruptcy Code, 11 U.S.C. 101 *et seq.*, over the objection of priority creditors whose rights are impaired by the proposed distribution. That is an issue of substantial importance to the United States. The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees throughout the country. 28 U.S.C. 581-589a. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena," H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977) (1977 Report), and they "may raise and may appear and be heard on any issue in any case or proceeding under" Title 11, 11 U.S.C. 307. The United States Trustee Pro-

gram thus acts in the public interest "to promote the integrity and efficiency of the bankruptcy system for the benefit of all stakeholders—debtors, creditors, and the public." U.S. Dep't of Justice, *United States Trustee Program Strategic Plan FY 2012-2016*, at 1, https://www.justice.gov/ust/strategic-plan-mission (last visited Sept. 1, 2016).

The United States is also the largest creditor in the Nation, frequently appearing as creditor in Chapter 11 cases. Certain tax claims, which by their nature involve debts owed to governmental units, have priority status in bankruptcy. 11 U.S.C. 503(b)(1)(B), 507(a)(2) and (8). In addition, several government agencies, including the Federal Deposit Insurance Corporation and the National Credit Union Administration, are entitled to assert priority claims in certain circumstances. See 11 U.S.C. 507(a)(2) and (9). Because a bankruptcy estate's assets are typically scarce, the United States has an interest in preventing bankruptcy courts from authorizing the distribution of estate assets in a manner that violates the rights of non-consenting priority creditors.

At the Court's invitation, the United States filed a brief as amicus curiae at the petition stage of this case.

STATEMENT

1. A company may file a bankruptcy petition pursuant to Chapter 7 or Chapter 11 of the Bankruptcy Code. In a Chapter 7 bankruptcy, the company's pre-petition assets are liquidated and distributed to creditors. 11 U.S.C. 701 *et seq.* A Chapter 11 bankruptcy, in contrast, is implemented through a "plan" that assigns to "classes" the various allowed claims and specifies the treatment each class of claims shall

receive, in exchange for a discharge of debts to the extent provided by the Code. 11 U.S.C. 1122, 1123, 1141.

In a Chapter 11 plan, each secured creditor typically is designated as a class unto itself. See Alan N. Resnik & Henry J. Sommer, 7 *Collier on Bankruptcy* ¶ 1122.03[3][c], at 1122-15 to 1122-16 (16th ed. 2016) (*Collier*). Among unsecured claims, the Code assigns "priority" to certain claims because of their "special social importance." S. Rep. No. 1106, 95th Cong., 2d Sess. 4 (1978) (1978 Report). Section 507—which applies to bankruptcies filed under Chapters 7 and 11, see 11 U.S.C. 103(a)—identifies claims entitled to priority and specifies the order in which they must be paid. 11 U.S.C. 507. Unsecured claims with priority include certain administrative expenses incurred during the bankruptcy proceeding; employee wages and benefits that were earned but not paid in the six months before the bankruptcy petition was filed; consumer deposits; and taxes. *Ibid.*

Under Section 507, wage claims have fourth priority, and contributions to employee benefit plans have fifth priority. 11 U.S.C. 507(a)(4) and (5). A bankruptcy court generally may confirm a proposed Chapter 11 plan only if each holder of a priority claim under Section 507 receives cash or deferred cash payments (depending on the circumstances) equal to the value of the claim as of the effective date of the plan, unless a particular claimholder "agree[s] to a different treatment of [its] claim." 11 U.S.C. 1129(a)(9). In addition to requiring that priority claimants be paid in full (unless they consent to different treatment), the Code establishes further prerequisites to plan confirmation with respect to non-priority unsecured credi-

tors. But full payment of Section 507 priority claims is a mandatory precondition of plan confirmation regardless of how other unsecured creditors may be treated under a plan. In a Chapter 7 liquidation, unsecured creditors with Section 507 priority claims are paid "in the order specified" in Section 507, 11 U.S.C. 726(a)(1), and other unsecured claimants may not receive any payments unless the priority claims are paid in full, 11 U.S.C. 726(a)(2).

While a bankruptcy case is pending, any legal claims the estate has against its creditors and others may be litigated or settled, usually by the debtor in possession or a trustee. During the pendency of a bankruptcy, a claim by a creditor that a debtor's assets were depleted by a fraudulent conveyance becomes a claim of the estate and is assigned to the trustee to pursue on behalf of the estate. 11 U.S.C. 544(b); see 11 U.S.C. 548(a) (trustee has exclusive right to pursue fraudulent-conveyance action in bankruptcy). In a Chapter 11 bankruptcy, such a claim (and others) may be pursued by a debtor in possession, who generally has the rights of a trustee. 11 U.S.C. 1107. In some circumstances, a bankruptcy court may authorize a committee of creditors to pursue claims on behalf of the estate. 11 U.S.C. 1103. A bankruptcy court may approve settlement of an estate claim if, after notice and a hearing, the court determines that the settlement is fair and equitable. Fed. R. Bankr. P. 9019, 11 U.S.C. App. at 757; see *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc.* v. *Anderson*, 390 U.S. 414, 424 (1968). Any proceeds from the litigation or settlement of the estate's claims become estate property subject to distri-

bution under the normal rules of priority. 11 U.S.C. 541(a)(3) and (6).

If the estate of a Chapter 11 debtor lacks sufficient funds to pay the priority claimholders in full in accordance with Section 1129(a)(9)(A)-(D) (typically in cash or deferred payments), and the priority claimants do not agree to different treatment under a plan, the case can either be converted to a Chapter 7 liquidation or dismissed. 11 U.S.C. 1112. An order of dismissal in a bankruptcy case ordinarily has the effect of vacating most orders entered during the proceedings and "revest[ing] the property of the estate in the entity in which such property was vested immediately before the commencement of the case" (usually the debtor). 11 U.S.C. 349(b)(3); see 11 U.S.C. 349(b)(2). The "objective" of a dismissal "is to undo the title 11 case, insofar as is practicable, and to restore all property rights to the position they occupied at the beginning of such case." 3 *Collier* ¶ 349.01[2], at 349-3. The bankruptcy court has discretion to alter the effects of its dismissal "for cause," 11 U.S.C. 349, such as by leaving its orders in force to protect the reliance interest of a good-faith purchaser, 3 *Collier* ¶ 349.01[2], at 349-3. Otherwise, if a Chapter 11 case is dismissed, creditors retain their pre-petition claims against the debtor (and any related fraudulent-conveyance claims they previously had against third parties) and can pursue them outside bankruptcy. 11 U.S.C. 349(b).

2. This case arises out of the bankruptcy of respondent Jevic Transportation, Inc. (Jevic), a trucking company, following its acquisition by respondent Sun Capital Partners (Sun) in a leveraged buyout. Pet. App. 2a. Sun financed the transaction by borrowing

against Jevic's assets. C.A. App. 733-734 (September 15, 2011, bankruptcy court opinion). When Jevic subsequently refinanced the loan, respondent CIT Group/Business Credit, Inc. (CIT) became the primary lender and obtained a lien on all of Jevic's assets. Pet. App. 36a; C.A. App. 734. In response to Jevic's deteriorating financial condition, Sun agreed to guarantee $2 million of Jevic's debt in exchange for CIT's agreement not to foreclose on Jevic's assets for a period of time. Pet. App. 2a; C.A. App. 735, 1162. Shortly before that agreement expired, Jevic's board of directors authorized a bankruptcy filing. Pet. App. 2a. Jevic then ceased substantially all of its operations, notified its employees that they would be fired, and filed a Chapter 11 bankruptcy petition. *Id.* at 2a-3a. When that petition was filed, Jevic owed approximately $53 million to CIT and Sun, who were first-priority secured creditors. *Id.* at 3a, 36a n.2.

As relevant here, two suits were filed in the bankruptcy court, one seeking to establish the estate's liabilities and the other asserting claims of the estate. First, petitioners—a group of Jevic's employee truck drivers—alleged violations of state and federal laws known as Worker Adjustment and Retraining Notification (WARN) Acts, which require in some circumstances that an employer give written notice to employees at least 60 days before laying them off. Pet. App. 3a (citing 29 U.S.C. 2102; and N.J. Stat. Ann. § 34:21-2 (West 2011)). The bankruptcy court granted summary judgment to petitioners on their claims against Jevic. *Id.* at 5a & n.2. An estimated $8.3 million dollars of petitioners' WARN Act claim is a priority wage claim under 11 U.S.C. 507(a)(4). Pet. App. 6a.

Second, after an Official Committee of Unsecured Creditors (Committee) was appointed to represent the interests of Jevic's unsecured creditors, the bankruptcy court authorized the Committee to pursue a fraudulent-conveyance action against Sun and CIT on behalf of the estate. Pet. App. 3a. The Committee alleged that Sun, with CIT's assistance, had "acquired Jevic with virtually none of its own money" and had "hastened Jevic's bankruptcy by saddling it with debts that it couldn't service." *Ibid.* (citation omitted). The Committee's complaint alleged, *inter alia*, that Sun's and CIT's liens were avoidable and that certain assets with significant value must be disgorged to the estate. See C.A. App. 764-854.

The bankruptcy court ultimately denied in part and granted in part Sun's and CIT's motion to dismiss the fraudulent-conveyance action, concluding that the Committee had adequately pleaded claims of fraudulent transfer and preferential transfer under 11 U.S.C. 547 and 548. Pet. App. 3a-4a. The court explained that "[a]n overly leveraged buyout that leaves the target company with unreasonably small capital—where it is reasonably foreseeable that the target will soon thereafter become insolvent—may provide the requisite factual predicate for an avoidance action grounded in fraudulent transfer law." C.A. App. 751. The court concluded that the Committee's complaint sufficiently alleged that CIT had played a critical role in facilitating a series of transactions that recklessly reduced Jevic's equity, increased its debt, and shifted the risk of loss to its other creditors. Pet. App. 4a.

The Committee, Jevic, CIT, and Sun then sought to negotiate a settlement of the Committee's fraudulent-conveyance action. Pet. App. 4a. By that point, Jev-

ic's only assets were the fraudulent-conveyance claim against CIT and Sun, and $1.7 million in cash, which was subject to Sun's lien. *Ibid.* The parties to the negotiations ultimately reached an agreement that would accomplish four things: (1) those parties would exchange releases of their claims against each other, and the bankruptcy court would dismiss the estate's fraudulent-conveyance action with prejudice; (2) CIT would pay $2 million into an account earmarked to pay Jevic's and the Committee's legal fees and other administrative expenses, but not otherwise available for distribution to creditors; (3) Sun would assign its lien on Jevic's remaining $1.7 million to a trust that would pay tax and administrative creditors, with the remainder to be distributed on a pro rata basis to the general unsecured creditors (but not to petitioners, who are higher-priority creditors); and (4) Jevic's Chapter 11 bankruptcy would be dismissed. *Id.* at 5a-6a. The proposed settlement did not provide for any payment to petitioners on their higher-priority WARN Act claims, and it left Jevic with no assets to satisfy those claims outside bankruptcy. *Id.* at 5a-7a.

3. The Committee, Jevic, CIT, and Sun moved in the bankruptcy court for approval of the settlement. See Pet. App. 53a. Petitioners and the United States Trustee opposed that motion, on the grounds that the proposed settlement would distribute estate assets to creditors of lower priority than petitioners, in contravention of the Bankruptcy Code's priority scheme, and that the Code does not contemplate or permit relief other than a confirmed plan, a Chapter 7 liquidation, or an outright dismissal. *Id.* at 7a, 53a, 57a.

In an oral ruling, the bankruptcy court granted the motion to approve the settlement, which it described

as a "global resolution" reached by "certain of the parties." Pet. App. 55a; see *id.* at 53a-66a. The court acknowledged that this type of resolution "is certainly neither favored nor commonplace"; that "no express[] provision in the code" authorizes the "distribution and dismissal contemplated by the settlement motion"; and that "the proposed distributions are not in accordance with the" Code's priority scheme. *Id.* at 57a, 58a. The court nevertheless approved the proposed disposition, explaining that, "because this is not a plan, and there is no prospect of a confirmable plan being filed, the absolute priority rule is not a bar to approval of this settlement." *Id.* at 58a. Because CIT and Jevic had liens on all of the estate's assets, the bankruptcy court determined that a disposition that would make money available to the unsecured creditors and some priority creditors was in the interest of the creditors as a group. *Id.* at 58a, 61a.

The bankruptcy court stated that the fairness of the proposed settlement depended in part on the likelihood that the Committee would ultimately prevail in its fraudulent-transfer action if that suit were litigated to its conclusion. Pet. App. 59a-60a. The court noted several "independent hurdles that the Committee would have to clear before it would actually see a material recovery out of the litigation." *Id.* at 60a. The court also noted that the estate (unlike CIT and Sun) had no available funds and would have a difficult time retaining counsel to pursue the case, notwithstanding the possibility of retaining contingency counsel or a Chapter 7 Trustee to continue the litigation. *Id.* at 61a. The bankruptcy court also concluded that petitioners were not prejudiced by dismissal of the case on those terms because petitioners' collective

WARN Act "claim against the estate [was] presently, effectively worthless given that the estate lack[ed] available unencumbered funds to satisfy it if it were allowed." *Ibid.*

4. The district court affirmed. Pet. App. 33a-43a. While stating that "the settlement does not follow the absolute priority rule," the court held that this deviation was "not a bar to the approval of the settlement as [the settlement] is not a reorganization plan." *Id.* at 42a. The court also concluded that "the settlement was in the best interest of the estate." *Id.* at 41a.

5. The court of appeals affirmed. Pet. App. 1a-23a. The court first held that a bankruptcy court has discretion to order a "structured dismissal" of a Chapter 11 bankruptcy, at least when there is "no prospect of a confirmable plan" and conversion to Chapter 7 would not be "worthwhile." *Id*. at 15a; see *id.* at 12a-15a. The court further held that a bankruptcy court may order such a "structured dismissal" even when the "settlement[] * * * skip[s] a class of objecting creditors in favor of more junior creditors." *Id.* at 15a; see *id.* at 15a-21a.

The court of appeals observed that the Second and Fifth Circuits had rendered conflicting decisions regarding the propriety of such settlements. Pet. App. 17a-18a. It sided with the Second Circuit, which had held that "the absolute priority rule 'is not necessarily implicated' when 'a settlement is presented for court approval apart from a reorganization plan.'" *Id.* at 18a (quoting *In re Iridium Operating LLC*, 478 F.3d 452, 463 (2d Cir. 2007) (*Iridium*)). The court of appeals rejected the approach adopted by the Fifth Circuit, which had held "that the 'fair and equitable' standard applies to settlements, and 'fair and equita-

ble' means compliant with the priority system." *Id.* at 17a (quoting *In re AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir.) (*AWECO*), cert. denied, 469 U.S. 880 (1984)). Instead, the court followed the Second Circuit in holding that, although "'compli[ance] with the Code's priority scheme must be the most important factor for the bankruptcy court to consider when determining whether a settlement is "fair and equitable" under Rule 9019,' * * * a noncompliant settlement could be approved when 'the remaining factors weigh heavily in favor of approving a settlement.'" *Id.* at 18a (quoting *Iridium*, 478 F.3d at 464).

The court of appeals held that the settlement and structured dismissal of Jevic's bankruptcy case was "the least bad alternative since there was 'no prospect' of a plan being confirmed and conversion to Chapter 7 would have resulted in the secured creditors taking all that remained of the estate in 'short order.'" Pet. App. 21a (quoting C.A. App. 32). While acknowledging that "the exclusion of [petitioners] certainly lends an element of unfairness," the court considered the critical question to be whether the settlement serves the interests of the "estate and the creditors as a whole," not "one particular group of creditors." *Id.* at 22a.

Judge Scirica dissented. Pet. App. 23a-32a. He stated that "the bankruptcy court's order undermined the Code's essential priority scheme." *Id.* at 23a. Although Judge Scirica would have followed the Second Circuit in permitting settlements contrary to the priority scheme in "extraordinary circumstances," he disagreed with the majority's conclusion that "this appeal presents an extraordinary case." *Id.* at 24a. He explained that it is "not unusual" for a debtor to enter Chapter 11 bankruptcy proceedings with liens

on all of its assets and with the goal of liquidating. *Id.* at 31a; see *id.* at 31a n.5 (citing study showing that 22% of surveyed companies entered Chapter 11 with secured claims exceeding the value of the estate). He further explained that, "to the extent that the only alternative to the settlement was a Chapter 7 liquidation, that reality was, at least in part, a product of [the settling parties'] own making." *Id.* at 25a.

SUMMARY OF ARGUMENT

A. The Bankruptcy Code establishes a detailed and interconnected set of protections for debtors, creditors, and the public. One integral feature of that scheme, which reflects bankruptcy practice that long predated the Code, is its identification of specific types of claims that are entitled to priority of payment. See 11 U.S.C. 507. A Chapter 11 plan of reorganization cannot be confirmed unless *either* claims that have priority status under Section 507 are paid in full *or* the holders of such claims consent to a different treatment. Congress has long identified employee wage claims as priority claims, and that treatment reflects Congress's judgment that payment of such claims serves especially important public interests. A bankruptcy court may not override that judgment based on its perception that a different allocation of estate assets would be fairer or more efficient.

If a bankruptcy estate lacks sufficient funds to pay all Section 507 priority creditors in full, and the priority creditors do not consent to less favorable treatment, the Code provides for conversion to Chapter 7 or dismissal of the bankruptcy case. If a case is converted to Chapter 7, priority creditors must be paid first, and in the order specified in Section 507, before any other unsecured creditors can receive estate as-

sets. If a case is dismissed, creditors can pursue their claims outside bankruptcy, pursuant to applicable non-bankruptcy state and federal law. Dismissal of the present case would have left petitioners free to pursue their WARN Act claims against Jevic, and to attempt to make assets available to pay any favorable judgment by pursuing a fraudulent-transfer claim against Sun and CIT.

The court of appeals appeared to recognize that the distribution of estate assets that occurred here, in which petitioners received nothing even though non-priority unsecured creditors received a portion of the estate's funds, would not have been permissible in a Chapter 11 reorganization plan or in a Chapter 7 liquidation. The court believed, however, that the constraints imposed by Section 507's priority rules do not apply to a distribution of estate assets that is undertaken pursuant to a structured dismissal of a case rather than pursuant to confirmation of a bankruptcy plan. That was error. Chapter 5 of the Code (which includes Section 507) applies to all "case[s] under," *inter alia*, Chapters 7 and 11, 11 U.S.C. 103(a), and Jevic's bankruptcy was a "case under" Chapter 11 even though it did not culminate in confirmation of a plan. Nothing in the Code authorized the bankruptcy court to use the expedient of case dismissal as a substitute for plan confirmation in order to distribute estate assets in a manner inconsistent with Section 507's priority scheme.

B. The court of appeals was also wrong in upholding the bankruptcy court's distribution of estate assets on the ground that the Code's priority rules do not apply to "settlements." To be sure, by providing that Section 507's priority rules apply to Chapter 11

plans "[e]xcept to the extent that the holder of a particular claim has agreed to a different treatment of such claim," 11 U.S.C. 1129(a)(9), the Code does contemplate that a particular priority creditor can validly consent to an impairment of the rights it would otherwise possess. The court below, however, invoked the purported "settlement" exception to the Code's priority rules to justify the bankruptcy court's impairment of petitioners' rights as priority creditors *over their objection*, on the ground that the proposed distribution of estate assets would best serve "the creditors as a whole." Pet. App. 22a. Neither the Code itself, nor the background rules that generally govern settlement of litigation, suggest that the consent of *other* parties to a bankruptcy can justify a deviation from the Code's priority scheme.

The bankruptcy court sought to justify its disposition on the ground that petitioners' WARN Act claims were "worthless" as a practical matter because the estate lacked unencumbered funds to pay a judgment in petitioners' favor. Pet. App. 61a. That assessment of the practical value of petitioners' claims rested in turn on the court's perception that the estate's fraudulent-conveyance claim against Sun and CIT was too contingent and uncertain to merit pursuit. If the bankruptcy had simply been dismissed, however, petitioners could have made their own determination whether to pursue a fraudulent-transfer action that, if successful, would have made funds available to satisfy a favorable WARN Act judgment. Because one term of the bankruptcy court's disposition was to dismiss the estate's fraudulent-transfer action with prejudice, that disposition effectively prevented petitioners from recovering on their

WARN Act claims. The bankruptcy court's disposition thus improperly deprived petitioners of their priority rights and their fraudulent-conveyance claim while giving them nothing in return.

ARGUMENT

The Bankruptcy Code prescribes a detailed scheme for resolving claims against an insolvent debtor. That scheme reflects Congress's careful balancing of competing interests and provides important protections for both debtors and creditors. See H.R. Rep. No. 996, 102d Cong., 2d Sess. 12-13 (1992) (1992 Report). The administration of a bankruptcy case is not a free-for-all in which the bankruptcy court may dispose of claims and distribute assets as it sees fit. Rather, although bankruptcy courts "are courts of equity and 'appl[y] the principles and rules of equity jurisprudence,'" *Young* v. *United States*, 535 U.S. 43, 50 (2002) (brackets in original) (quoting *Pepper* v. *Litton*, 308 U.S. 295, 304 (1939)), their discretion is limited by the detailed scheme set forth in the Code, which reflects Congress's effort to strike a balance that is fair, equitable, and sufficiently flexible to accommodate the interests of debtors, creditors, and the public.

In this case, the bankruptcy court ignored the carefully crafted options that Congress made available in a Chapter 11 case and instead approved a distribution of estate assets that contravenes the Code's priority scheme. The court of appeals offered two basic justifications for approving that disposition. First, the court of appeals relied on the fact that the bankruptcy court had dismissed the case rather than confirming a Chapter 11 plan of reorganization. Second, the court viewed the Code's priority rules as inapplicable to bankruptcy "settlements." Pet. App. 58a-61a. As we

explain below, neither of those rationales justifies the bankruptcy court's disposition of this case, which deprived petitioners of their rights as priority creditors *without* their consent.

A. The Courts Below Erred By Approving A Distribution Of Estate Assets In A Manner Not Provided For In The Bankruptcy Code

Under the rules set forth in the Bankruptcy Code, both debtors and creditors lose certain rights they would otherwise possess while receiving certain protections. In the Chapter 11 context, a corporate debtor gives up the right to control the distribution of its assets, and a creditor gives up its state-law right to seek full repayment on its claim. In exchange, a Chapter 11 debtor enjoys protections such as the automatic stay that generally freezes efforts to collect pre-petition debts, 11 U.S.C. 362; and the discharge of liability on debts that are addressed in a plan of reorganization, 11 U.S.C. 1141(d); see *Burlingham* v. *Crouse*, 228 U.S. 459, 473 (1913) (noting that the Bankruptcy Code "give[s] the bankrupt a fresh start with such * * * rights as the [bankruptcy] statute left untouched"). A Chapter 11 creditor can rely on protections such as the Code's detailed priority scheme, which requires that certain types of creditors be paid in full through a bankruptcy before other types of creditors may receive any distribution, 11 U.S.C. 507; and the rule that a plan of reorganization may not pay a junior class of creditors or interests unless every senior class is either unimpaired or consents to impairment, 11 U.S.C. 1129(a)(8) and (b)(1). In this case, the lower courts held that a bankruptcy court may upend this carefully balanced system by approving the disposition of a case in a manner

that is not authorized by the Code and that does not respect the protections Congress has extended to particular types of creditors. The Bankruptcy Code does not allow such a disposition.

The "uniform national bankruptcy system * * * is designed to achieve two equally important objectives": "to provide honest debtors who have fallen on hard times the opportunity for a fresh start in life," and "to protect creditors in general by preventing an insolvent debtor from selectively paying off the claims of certain favored creditors at the expense of others." 1992 Report 12-13; H.R. Rep. No. 835, 103d Cong., 2d Sess. 32-33 (1994) (1994 Report) (same). Recognizing the "inevitable temptation among creditors to fiercely compete over the debtor's limited funds," Congress designed a system "in which the claims of all creditors are considered fairly, in accordance with established principles rather than on the basis of the inside influence or economic leverage of a particular creditor." 1992 Report 13; see 1994 Report 33. In pursuit of those goals, the Bankruptcy Code contemplates three possible dispositions of a Chapter 11 case: a plan of reorganization, conversion to a Chapter 7 bankruptcy, or dismissal of the case. The bankruptcy court exceeded its authority when it ordered a fourth type of disposition that does not comply with the Code provisions applicable to any of the three dispositions contemplated by the Code.

1. To achieve a fair and orderly disposition of creditors' claims in a Chapter 11 bankruptcy, Congress created a set of rules to govern plans of reorganization. 11 U.S.C. 1121-1129. One essential feature of the statutory scheme is its identification of specific types of claims that are entitled to priority of pay-

ment. The overarching principle of plan construction (implemented in two steps) is that claimholders (or classes of claimholders) with senior priority must either be paid in full or consent to impairment before a plan may provide for payment to claims or classes of claims or interests that are junior.

a. In the bankruptcy context, the term "priority" has long been used to refer to claims that are entitled to be paid before other claims. See *United States* v. *Bryan & Woodcock*, 13 U.S. (9 Cranch) 374, 387 (1815). In Section 507 of the Code, 11 U.S.C. 507, Congress granted "priority" status to a "narrow[] set of specified types of claims, including certain tax obligations and limited past due wages to a debtor's employees," by requiring that such claims "be paid in full" before non-priority (or lower-priority) creditors receive "any distribution." 1992 Report 13; see 1994 Report 33; 1978 Report 4 (noting that the Code "giv[es] priority in the distribution of assets of the debtor's estate to certain claims with special social importance"). Section 507 applies to most bankruptcy proceedings, including cases filed under Chapters 7 and 11, see 11 U.S.C. 103(a), and generally "affect[s] claims of unsecured creditors," 1978 Report 4.

Section 507 provides that certain enumerated "expenses and claims have priority in the * * * order" specified. 11 U.S.C. 507(a). Because that provision "appl[ies] in a case under chapter 7, 11, 12, or 13," 11 U.S.C. 103(a), it governs Jevic's Chapter 11 bankruptcy. In the Chapter 11 context, a plan of reorganization cannot be confirmed unless *either* claims that are afforded priority status by operation of Section 507 are paid in full (with cash or deferred cash payments) *or* the holders of such claims consent to a dif-

ferent treatment. 11 U.S.C. 1129(a)(9). That requirement applies regardless of how other claims are treated in a reorganization plan.

Since the earliest American bankruptcy laws, Congress has sought to achieve "the equitable distribution of the debtor's assets amongst his creditors." *Kuehner* v. *Irving Trust Co.*, 299 U.S. 445, 451 (1937); see *United States* v. *Embassy Rest., Inc.*, 359 U.S. 29, 31 (1959) (same). Because many bankruptcy estates do not have sufficient assets to pay all creditors in full, the Code establishes rules for allocating the existing assets among the holders of claims. If parity of treatment were Congress's only objective in drafting the Code, Congress would have provided for a pro rata distribution of assets among all creditors (or perhaps among all unsecured creditors after secured claims were satisfied). See 4 *Collier* ¶ 507.02[1], at 507-13. Instead, Congress has long chosen to prefer certain types of claims over other types of claims.

The statutory provisions that assign priority to certain claims reflect Congress's policy determination that full payment of those claims, when possible, is in the public interest. The type of priority claim at issue here—employee wage claims—has enjoyed priority status since at least 1841. See *Embassy Rest.*, 359 U.S. at 31 & n.4 (citing Act of Aug. 19, 1841, ch. 9, § 5, 5 Stat. 445); 4 *Collier* ¶ 507.06[1], at 507-27 ("A priority for wages was included as part of the Bankruptcy Act upon its original enactment in 1898 and has been a feature of the bankruptcy law since that time."). Congress's objective in establishing that priority "has constantly been to enable employees displaced by bankruptcy to secure, with some promptness, the money directly due to them in back wages, and thus to

alleviate in some degree the hardship that unemployment usually brings to workers and their families." *Embassy Rest.*, 359 U.S. at 32; see *id.* at 33 ("[T]he purpose for which Congress established the priority * * * was to provide the workman a 'protective cushion' against the economic displacement caused by his employer's bankruptcy."); 4 *Collier* ¶ 507.02[1][d], at 507-14 ("Employees are viewed as having a special right to payment since their labor has helped to create the assets from which other creditors will be able to realize value and because their wages are often their only source of income. Creditors other than employees generally have not relied on the debtor as their sole source of income.").

Congress has similarly accorded priority status to tax claims since the early days of the Nation's bankruptcy laws. 4 *Collier* ¶ 507.LH[1], at 507-92. "[T]axes are the life-blood of government," *Bull* v. *United States*, 295 U.S. 247, 259 (1935), and taxing entities (like employees, but unlike most Chapter 11 creditors) do not extend credit voluntarily. Compare 1977 Report 190 (explaining that a "taxing authority is given preferred treatment because it is an involuntary creditor of the debtor"), with 4 *Collier* ¶ 507.02[1][d], at 507-14 ("[E]mployees in waiting for their paychecks do not consider themselves as extending credit to the debtor."). Although this case does not present any question concerning the proper treatment of tax claims, such claims are frequently at issue in Chapter 11 bankruptcies.

By giving statutory priority to wage claims, tax claims, and the other types of claims identified in Section 507 (including, *inter alia*, domestic-support obligations, administrative expenses, and contribu-

tions to employee benefit plans, 11 U.S.C. 507(a)(1), (2), and (5)), Congress has expressed its judgment that those claims have "special social importance." 1978 Report 4. That judgment may not be overridden by a bankruptcy court, at least absent the type of misconduct, not present here, that would justify equitable subordination of a priority claim pursuant to 11 U.S.C. 510(c). See *United States* v. *Noland*, 517 U.S. 535, 540-543 (1996).

b. As noted, the full payment of claims entitled to priority under Section 507 is a prerequisite to the confirmation of any Chapter 11 plan, unless the holder of a priority claim consents to less favorable treatment. 11 U.S.C. 1129(a)(9). The general principle that some claims must be paid before other claims may receive any distribution is also reflected in the rules that govern the treatment in a plan of classes of other unsecured creditors (*i.e.*, those with non-priority claims). An unsecured claim that is not entitled to priority under Section 507 must be assigned to a class, either alone or with other "substantially similar" claims. 11 U.S.C. 1122(a). Then, as a condition of confirmation, a plan must conform to the "absolute priority rule," 1977 Report 413, by providing for the distribution of estate assets such that a senior class of claims must receive the value of its claims before any junior class of claims or interests receives any distribution. See 11 U.S.C. 1129(b). That condition is reflected in the requirement that any plan be "fair and equitable," 11 U.S.C. 1129(b)(1), a phrase that has long been construed in the Chapter 11 context to require that a plan conform to the absolute priority rule. See *Northwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 202 (1988); George M. Treister et al. *Fundamen-*

tals of Bankruptcy Law § 9.04(f)(1), at 423 (5th ed. 2004). As with Section 507 priority, parties to a bankruptcy may depart from the absolute priority rule, but only when the class of claimholders whose rights would be impaired by a contemplated disposition of assets consents to the impairment. 11 U.S.C. 1129(a)(8) and (b)(2)(B).[1]

2. If a bankruptcy estate lacks sufficient funds to pay Section 507 priority creditors in full, and the priority creditors do not consent to less favorable treatment, the Code provides for two other options: conversion to Chapter 7 or dismissal. Both of those dispositions respect the relative rights of creditors, as determined by Congress and state legislatures.

Conversion of a Chapter 11 case to Chapter 7 typically takes place when an estate does not have sufficient assets to pay all creditors who are entitled to priority under Section 507. After conversion, the rights of priority creditors are protected by Chapter 7's requirement that priority creditors must be paid first and in the order specified in Section 507. 11 U.S.C. 726(a). That requirement ensures that a claim with relatively lower priority within Section 507 can-

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[1] In discussing the governing legal principles, the court below referred repeatedly to the "absolute priority rule." See Pet. App. 16a-17a. As noted, the term "absolute priority rule" is most accurately used to refer to the requirement in 11 U.S.C. 1129(b) that junior classes of creditors may not be paid through a plan of reorganization unless senior classes of creditors either receive the full value of their allowed claims or consent to an impairment of their rights. The court of appeals used the phrase to encompass the additional rule that, unless they consent to less favorable treatment, creditors with claims entitled to priority under Section 507 must be paid in full through a plan before any lower-priority (or non-priority) creditor is paid.

not be paid unless all claimholders with higher priority have been fully paid.

In the alternative, a Chapter 11 case that does not (or cannot) result in a confirmable plan of reorganization (or liquidation, see 11 U.S.C. 1123(b)(4)) can be dismissed. 11 U.S.C. 349. Such a dismissal leaves creditors free to pursue their claims outside bankruptcy, pursuant to applicable non-bankruptcy state and federal law. 11 U.S.C. 349(b). When a bankruptcy is dismissed, the requirements and protections established by the Code no longer apply, and the parties recover the rights that they lost during the pendency of the bankruptcy case. If the bankruptcy court had dismissed this case, petitioners would have been free to pursue their WARN Act claims against Jevic and a fraudulent-conveyance claim against Sun and CIT. See pp. 31-32, *infra*.

3. The court of appeals held that a bankruptcy court may dispose of a Chapter 11 case in a manner that is not authorized by the Code and that violates the priority scheme set forth in Section 507. The court erred by approving a bankruptcy disposition that furthered the interests of the debtor and non-priority creditors at the expense of objecting priority creditors.

The court below appeared to recognize that a plan of reorganization must provide full payment to Section 507 priority creditors unless such creditors consent to less favorable treatment. Pet. App. 16a-17a. The court concluded, however, that the same principle does not apply when the disposition of a bankruptcy case does not involve a plan of reorganization or a liquidation under Chapter 7. *Id.* at 17a. Nothing in the Code supports that conclusion. On the contrary,

as noted, the Code specifies that Chapter 5 (which includes Section 507) applies to all "case[s] under," *inter alia*, Chapters 7 and 11. 11 U.S.C. 103(a). Although Jevic's bankruptcy did not culminate in confirmation of a plan, it was a "case under" Chapter 11, and any disposition of estate assets authorized by the terms of its dismissal therefore was subject to the priority scheme set forth in Section 507.

Although the priority scheme set forth in Section 507 is not inviolable, Congress has specified the circumstances in which a court may deviate from that scheme, and none of those circumstances was present here. See, *e.g.*, 11 U.S.C. 726(a) (incorporating "equitable subordination" exception in 11 U.S.C. 510, which permits a bankruptcy court to reorder particular priority claims in a Chapter 7 liquidation); 11 U.S.C. 1129(a)(9), 1222(a)(2)(B), 1322(a) (authorizing plan confirmation when a priority creditor consents to abrogation of its rights). "Where Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied, in the absence of evidence of a contrary legislative intent." *Hillman* v. *Maretta*, 133 S. Ct. 1943, 1953 (2013) (quoting *Andrus* v. *Glover Constr. Co.*, 446 U.S. 608, 616-617 (1980)). No such evidence exists here.

Congress could have created a system in which individual bankruptcy courts would apply principles of fairness or equity to determine which Chapter 11 claims should be paid in full and which should be paid in part or not at all. Congress did not do that. Congress instead created a clear and detailed set of rules to "standardize[] an expansive (and sometimes unruly) area of law." *RadLAX Gateway Hotel, LLC* v. *Amalgamated Bank*, 132 S. Ct. 2065, 2073 (2012); see James

M. Henderson, 6 *A Treatise on the Bankruptcy Law of the United States* § 2778, at 343 (5th ed. 1952) (noting, with respect to the pre-Code Bankruptcy Act, ch. 541, 30 Stat. 544, that "[n]o power exists in a court of bankruptcy to accord priority of payment to a general creditor on broad principles of equity jurisprudence").

"[I]n exercising [its] statutory and inherent powers, a bankruptcy court may not contravene specific statutory provisions." *Law* v. *Siegel*, 134 S. Ct. 1188, 1194 (2014). The Code provides for three possible dispositions of a Chapter 11 case: (1) a plan of reorganization; (2) conversion to Chapter 7; or (3) dismissal. Nothing in the Code authorizes a court to approve a disposition that is essentially a substitute for a plan but does not comply with the priority scheme set forth in Section 507. That is what the bankruptcy court did here, and the court of appeals erred in affirming that disposition.

B. The Code Does Not Permit A Bankruptcy Court To Abrogate The Rights Of Nonconsenting Priority Claimholders Based On The Agreement Of Other Parties

In approving the bankruptcy court's disposition of this case, the court of appeals also relied on the purported status of that disposition as a voluntary "settlement." See Pet. App. 17a-21a. That was error. Although *other* parties to the case agreed to the bankruptcy court's disposition, those parties had no authority to settle petitioners' own priority claims. Their agreement consequently provided no sound basis for the court to deviate from the Code's priority scheme at petitioners' expense.

1. The court of appeals concluded that the Code's priority rules "do not extend * * * to settlements in bankruptcy." Pet. App. 20a. As noted, the Code specifies that Section 507 (which is included in Chapter 5) applies to all "case[s] under," *inter alia*, Chapters 7 and 11. 11 U.S.C. 103(a). Despite the bankruptcy court's conclusion that no confirmable plan of reorganization could be devised, the case remained a "case under" Chapter 11 and was therefore subject to the priority scheme set forth in Section 507.

Because Section 507's priority rules apply to Chapter 11 plans "[e]xcept to the extent that the holder of a particular claim has agreed to a different treatment of such claim," 11 U.S.C. 1129(a)(9), a particular priority creditor can validly consent to an impairment of the rights it would otherwise possess. The court below, however, invoked the purported "settlement" exception to the Code's priority rules to justify the bankruptcy court's impairment of petitioners' rights as priority creditors *over their objection*, on the ground that the proposed distribution of estate assets would best serve "the creditors as a whole." Pet. App. 22a. Neither the Code itself, nor the background rules that generally govern settlement of litigation, support that result. To the contrary, by authorizing "the holder of a particular claim" to "agree[] to a different treatment of such claim," 11 U.S.C. 1129(a)(9), the Code reinforces the natural inference that *other* parties cannot give valid consent to impairment of a priority creditor's rights.

The court of appeals believed that bankruptcy courts should have "more flexibility in approving settlements than in confirming plans of reorganization." Pet. App. 20a. But the Code itself provides

the best evidence of the kind and degree of flexibility that Congress deemed appropriate. A bankruptcy court is permitted to approve a disposition of a case that is not specifically provided for in the Code when *all* of the parties whose rights would be impaired by that disposition have consented. That degree of flexibility did not exist under pre-Code versions of the Bankruptcy Act. See *Fundamentals of Bankruptcy Law* § 903(f)(1), at 423. But under the Code, plan rules are flexible when creditors agree to impairment of their rights, and "Chapter 11 is flexible enough to accommodate whatever deal the parties with creditor or equity interests in the debtor can work out among themselves." *Id.* § 9.03(b), at 387.

The court of appeals justified the bankruptcy court's disposition of the case by stating that no other option "would have better served * * * the creditors as a whole." Pet. App. 22a. That reasoning was misguided. In certain carefully calibrated respects, the Code protects "creditors as a whole," by allowing parties to work out consensual compromises in crafting a Chapter 11 plan, and by permitting majority-rule approval of a plan within a class of impaired unsecured creditors (who are not protected under Section 507), even over the objection of a particular creditor within the class. But the Code's priority scheme unambiguously gives some creditors a right to collect that is superior to that of other creditors. That hierarchical system cannot function in its intended manner if individual judges feel free to disregard it based on the perceived interests of "the creditors as a whole."

2. Bankruptcy Rule 9019 authorizes a bankruptcy court to approve a "compromise or settlement." Fed.

R. Bankr. P. 9019, 11 U.S.C. App. at 757. That rule typically governs the settlement of a claim of the estate against a third party (including a creditor). A bankruptcy court may approve a settlement over the objection of a creditor if the court determines that the proposed settlement is "fair and equitable," after considering the nature of the claim and the likely range of outcomes if the estate were to pursue the claim to judgment. *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc.* v. *Anderson*, 390 U.S. 414, 424 (1968). If the bankruptcy court had simply approved a compromise of the estate's fraudulent-transfer suit against Sun and CIT, while otherwise administering the case in a manner consistent with the Code's priority scheme, petitioners' status as priority creditors would not have given them any absolute right to veto that compromise.

The "settlement" that the courts below approved, however, did not simply convert the estate's fraudulent-conveyance action to money that would become part of the estate pursuant to 11 U.S.C. 541(a)(6). Rather, the agreement and order took the further step of distributing those assets in a manner inconsistent with Section 507. Even assuming that the bankruptcy court could have approved that disposition with the consent of all affected parties, it had no authority to abrogate the rights of nonconsenting creditors in a manner not provided for in the Code. The consent of *other* parties who benefitted from the proposed disposition is not a substitute for the consent of the impaired party. Cf. *Martin* v. *Wilks*, 490 U.S. 755, 768 (1989) ("A voluntary settlement in the form of a consent decree between one group of employees and their employer cannot possibly 'settle,' voluntarily or

otherwise, the conflicting claims of another group of employees who do not join in the agreement.").

The court of appeals purported to limit its approval of this type of disposition to cases in which a bankruptcy court has "specific and credible grounds to justify [the] deviation." Pet. App. 21a (citation omitted; brackets in original). But the grounds on which the court relied—that "there was 'no prospect' of a plan being confirmed and conversion to Chapter 7 would have resulted in the secured creditors taking all that remained of the estate in 'short order,'" *ibid.* (citation omitted)—are not permissible reasons to deviate from the Code's priority scheme over the objection of the impaired parties. If a plan cannot be confirmed and conversion to Chapter 7 is not feasible, the Code provides a third option: dismissal of the bankruptcy.

The court of appeals is correct that, "[a]s in other areas of the law, settlements are favored in bankruptcy." Pet. App. 19a. Both in bankruptcy and in other legal settings, however, the legal rules that establish parties' rights and obligations provide the background against which parties negotiate towards a settlement. In this context, the priority scheme in Section 507 provides the default rule that will govern if the parties fail to reach a global agreement. The public policy favoring settlement of litigation may justify deviations from the Code's priority scheme when a priority creditor consents to a diminution of its rights. But that policy provides no basis for the disposition that occurred here, in which the bankruptcy court approved the distribution of estate assets in a manner inconsistent with the Code's priority scheme *without* the

agreement of the creditors whose rights were impaired.

The related absolute priority rule under Section 1129 is designed to protect intermediate creditors from being squeezed out by a deal between senior and junior creditors. See 1977 Report 416 (explaining that the absolute priority rule "is designed to prevent a senior class from giving up consideration to a junior class unless every intermediate class consents, is paid in full, or is unimpaired"). Although the priority scheme in Section 507 has the same goal, the bankruptcy court in this case approved the very machination that the absolute priority rule is intended to prevent, with secured creditors and junior unsecured creditors taking all of the estate assets and leaving unconsenting priority unsecured creditors with nothing. If the bankruptcy court had enforced the Code's prohibition of that result, and had treated petitioners' consent as a precondition for approval of any disposition that impaired their rights under the Code, the parties might have reached a different global agreement that gave those priority creditors a share of the estate's assets. Cf. *Fundamentals of Bankruptcy* § 9.04(f)(1), at 425 ("[T]he lurking presence of the absolute priority rule influences the negotiating process over the terms of a plan. Seniors are willing to give up some limited reorganization value to juniors to achieve a consensual plan so as to avoid the time, expense, and risks that are involved in testing the rule. Juniors are motivated to make only reasonable demands because application of the absolute priority rule may result in their receiving nothing under the reorganization plan.").

3. In justifying its disposition of the case, the bankruptcy court relied on its own assessment of the strength of the various claims at issue. The court stated that petitioners would not be prejudiced by approval of the settlement because petitioners' WARN Act "claim against the estate is presently, effectively worthless given that the estate lacks available unencumbered funds to satisfy it if it were allowed." Pet. App. 61a. The court's view that petitioners' WARN Act claims were "worthless" rested on its belief that the estate's fraudulent-conveyance claim was too contingent and uncertain to merit pursuit. *Id.* at 60a-61a.

If the bankruptcy case had simply been dismissed, petitioners could have pursued a fraudulent-conveyance action against Sun and CIT on their own behalf as creditors of Jevic. And if that action had been successful, funds would have been available to satisfy Jevic's WARN Act obligations to petitioners. Of course, if petitioners shared the bankruptcy court's view that a fraudulent-conveyance action would have no realistic prospect of success, and that their WARN Act claims therefore were "effectively worthless," Pet. App. 61a, they might well have agreed to a global settlement that provided them only a very modest recovery. By approving a disposition of the case that abrogated petitioners' rights *without* their consent, however, the bankruptcy court pretermitted the negotiations that might have produced a truly global agreement.[2]

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[2] The bankruptcy court's assessment that petitioners' claims were "effectively worthless" because the estate's fraudulent-conveyance action was unlikely to produce any actual recovery, Pet. App. 61a, is difficult to square with the deal that was struck.

Within the bankruptcy case, Jevic (as debtor in possession) had the exclusive right to pursue (on behalf of all of its creditors) any claim that Jevic's assets had been depleted by a fraudulent conveyance. 11 U.S.C. 544(b) (assigning such claims to trustee); 11 U.S.C. 1107 (Chapter 11 debtor in possession has rights of trustee); see 11 U.S.C. 548(a) (trustee has exclusive right to pursue fraudulent-conveyance action in bankruptcy); see also *In re Cybergenics Corp.*, 226 F.3d 237, 241-245 (3d Cir. 2000); Patrick A. Murphy et al., *Creditors' Rights in Bankruptcy* § 13:5, at 469 (2d ed. 2014). The bankruptcy court initially authorized the Committee to pursue that claim on the estate's behalf. When the court subsequently approved the purported settlement, the fraudulent-conveyance claim against Sun and CIT (which belonged to Jevic's creditors) was dismissed with prejudice, precluding petitioners from pursuing it outside bankruptcy. See *In re PWS Holding Corp.*, 303 F.3d 308, 313-315 (3d Cir. 2002), cert. denied, 538 U.S. 924 (2003). The effect of the "settlement" thus was to deprive petitioners, without their consent and without complying with the Code's priority scheme, of a potentially valuable cause of action that they could have asserted if the bankruptcy case had simply been dismissed.

Although Sun presumably would have exited a Chapter 7 conversion with at least some of the $1.7 million that secured its assets, Sun and CIT together agreed to give up a total of $3.7 million (by paying $2 million to a fund for legal fees and administrative expenses, and by giving up the $1.7 million that secured Sun's lien) in exchange for a release from the fraudulent-conveyance claim (held at the time by the estate on behalf of Jevic's creditors). *Id.* at 5a.

* * * * *

The Bankruptcy Code is a detailed scheme that reflects Congress's determination of what constitutes a fair bargain for debtors and creditors in bankruptcy. And while the Code contemplates that creditors may consent to an impairment of the rights they would otherwise possess, petitioners did not give such consent here. The bankruptcy court's disposition of the case was not authorized by any Code provision, it contravened the Code's priority scheme, and it was entered over the objection of the priority creditors whose rights were impaired. The bankruptcy court's view that this result served the best interests of "the creditors as a whole" was a legally insufficient basis for the order that it entered, which deprived petitioners of their priority rights and their fraudulent-conveyance claim while giving them nothing in return.

CONCLUSION

The decision of the court of appeals should be reversed.

Respectfully submitted.

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SEPTEMBER 2016

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No. 16-348

In the Supreme Court of the United States

MIDLAND FUNDING, LLC, PETITIONER

v.

ALEIDA JOHNSON

*ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT*

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QUESTIONS PRESENTED

1. Whether the filing of an accurate proof of claim for an unextinguished time-barred debt in a bankruptcy proceeding violates the Fair Debt Collection Practices Act.

2. Whether the Bankruptcy Code, which governs the filing of proofs of claim in bankruptcy, precludes the application of the Fair Debt Collection Practices Act to the filing of an accurate proof of claim for an unextinguished time-barred debt.

CORPORATE DISCLOSURE STATEMENT

Petitioner Midland Funding, LLC, is a subsidiary of Encore Capital Group, Inc., a publicly held company. Encore Capital Group has no parent corporation, and no publicly held company owns 10% or more of its stock.

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In the Supreme Court of the United States

No. 16-348

MIDLAND FUNDING, LLC, PETITIONER

v.

ALEIDA JOHNSON

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-15a) is reported at 823 F.3d 1334. The order of the district court granting petitioner's motion to dismiss (Pet. App. 18a-37a) is reported at 528 B.R. 462.

JURISDICTION

The judgment of the court of appeals was entered on May 24, 2016. A petition for rehearing was denied on August 19, 2016 (Pet. App. 16a-17a). The petition for a writ of certiorari was filed on September 16, 2016, and granted on October 11, 2016. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTORY PROVISIONS AND RULES INVOLVED

Relevant provisions of the Bankruptcy Code, 11 U.S.C. 101-1532; the Fair Debt Collection Practices Act, 15 U.S.C. 1692-1692p; and the Federal Rules of Bankruptcy Procedure are reproduced in an appendix to this brief.

STATEMENT

This case presents two related questions concerning the interplay between the Bankruptcy Code (Code) and the Fair Debt Collection Practices Act (FDCPA). The Code entitles a creditor to file a proof of claim in a bankruptcy proceeding. Together with the accompanying rules, the Code requires a creditor seeking to collect on specified types of consumer debt to include certain information in the proof of claim, so as to enable parties in interest to assess the claim's timeliness, and it provides a remedial scheme to address abusive or otherwise improper filings. The earlier-enacted FDCPA prohibits debt collectors from engaging in collection practices that are deceptive, misleading, unfair, or unconscionable. The questions presented by this case are, first, whether a debt collector violates the FDCPA by filing an accurate proof of claim for an unextinguished time-barred debt in a bankruptcy proceeding, and second, whether the Bankruptcy Code precludes such an application of the FDCPA.

Petitioner is a debt purchaser that acquired respondent's defaulted credit-card debt. When respondent filed for bankruptcy, petitioner filed a proof of claim in her bankruptcy case. The proof of claim accurately listed the amount of the debt and other required information, including the date of the last transaction on respondent's account. Because that date was more than six years before petitioner's filing, the debt appears to have been

time-barred under the relevant state law. Respondent objected to petitioner's claim, and the bankruptcy court disallowed it.

Three days later, respondent filed a separate lawsuit against petitioner outside the bankruptcy proceeding, alleging that the filing of a proof of claim on a time-barred debt in the bankruptcy proceeding violated the FDCPA. The district court granted petitioner's motion to dismiss. In a decision contrary to decisions from every other court of appeals to have considered the issue, the Eleventh Circuit reversed and remanded. The Eleventh Circuit recognized that the Code permits creditors to file proofs of claim for time-barred debts in bankruptcy proceedings. It nevertheless held, first, that debt collectors violate the FDCPA when they file such proofs of claim, and, second, that the Code does not preclude applying the FDCPA to prohibit such filings. Both of those holdings were incorrect, and the Eleventh Circuit's judgment should be reversed.

A. Background

1. "The principal purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor." *Marrama* v. *Citizens Bank of Massachusetts*, 549 U.S. 365, 367 (2007) (internal quotation marks and citation omitted). An individual debtor can commence a bankruptcy proceeding by filing a voluntary petition, typically under Chapter 7 or Chapter 13 of the Code. See 11 U.S.C. 301. At that point, the debtor's property becomes part of the bankruptcy estate. See 11 U.S.C. 541(a). In connection with the filing of the petition, the debtor is required to file a list of creditors and a schedule of assets and liabilities. See 11 U.S.C. 521(a)(1)(A), (B)(i).

The Code establishes the procedures by which debtors "can reorder their affairs, make peace with their creditors, and enjoy a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." *Grogan* v. *Garner*, 498 U.S. 279, 286 (1991) (internal quotation marks and citation omitted). Specifically, the Code provides that, "[w]hen a debtor declares bankruptcy, each of [the debtor's] creditors is entitled to file a proof of claim" against the estate. *Travelers Casualty & Surety Co.* v. *Pacific Gas & Electric Co.*, 549 U.S. 443, 449 (2007); see 11 U.S.C. 501. Consistent with bankruptcy's goal of resolving all potential claims against the debtor, the Code defines a "claim" as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. 101(5)(A). As this Court has repeatedly recognized, that language gives the term "claim" the "broadest available definition." *Johnson* v. *Home State Bank*, 501 U.S. 78, 83 (1991); see *FCC* v. *NextWave Personal Communications Inc.*, 537 U.S. 293, 302 (2003).

"Once a proof of claim has been filed, the court must determine whether the claim is 'allowed' under [Section] 502(a) of the Bankruptcy Code." *Travelers*, 549 U.S. at 449. In consumer bankruptcies, the Code provides for the appointment of a trustee, who is required to examine proofs of claim and, where appropriate, object to any improper claim. See 11 U.S.C. 704(a)(5), 1302(b)(1). By default, a claim is deemed allowed unless the trustee or some other party in interest (such as the debtor or another creditor) objects. See 11 U.S.C. 502(a). If there is an objection, the bankruptcy court must determine whether the claim should be disallowed under any of the "exceptions"

listed in the Code. See 11 U.S.C. 502(b); *Travelers*, 549 U.S. at 449.

As is relevant here, a claim may be disallowed because it is "unenforceable * * * under any * * * applicable law for a reason other than because such claim is contingent or unmatured." 11 U.S.C. 502(b)(1). The Code specifically provides that the estate is entitled to invoke any "defense" that would have been available to the debtor, "including statutes of limitation." 11 U.S.C. 558. For claims based on certain types of consumer credit agreements (such as credit-card agreements), the Federal Rules of Bankruptcy Procedure require the creditor to disclose certain information in the proof of claim, including the date of the account holder's last transaction; the date of the last payment on the account; and the date the account was charged to profit and loss. See Fed. R. Bankr. P. 3001(c)(3)(A)(iii)-(v). The purpose of requiring those additional disclosures is to aid parties in interest in "assessing the timeliness of the claim." Fed. R. Bankr. P. 3001 advisory committee's notes (2012).

Beyond the procedures for the filing and allowance of claims, which ensure the comprehensiveness of the bankruptcy process and the equitable distribution of assets, the Code provides several additional protections for debtors. Once a debtor declares bankruptcy, the Code's automatic-stay provision operates to enjoin any act to "collect, assess, or recover a [preexisting] claim against the debtor," such as phone calls and letters to the debtor seeking to obtain a payment on the debt. 11 U.S.C. 362(a)(6). At the conclusion of the bankruptcy process, moreover, the Code discharges all debts that have been brought into the bankruptcy process. See 11 U.S.C. 523(a)(3), 727(b). Discharge provides the fresh start promised by bankruptcy and protects the debtor from any future acts to recover discharged debts, as well as from various forms of

discrimination based on the nonpayment of those debts. See 11 U.S.C. 524(a), 525.

The Bankruptcy Code has a comprehensive remedial scheme for abusive or otherwise improper actions taken in bankruptcy proceedings. The Code permits a bankruptcy court to "tak[e] any action or mak[e] any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." 11 U.S.C. 105(a). In addition, the Federal Rules of Bankruptcy Procedure state that the presentation of any document to the court constitutes a certification that the document is not presented "for any improper purpose" and that any "legal contentions * * * are warranted by existing law" (or by an argument for modifying the law). Fed. R. Bankr. P. 9011(b). Violations of that provision are punishable by sanctions specified in the Rules. See Fed. R. Bankr. P. 9011(c).

2. This case results from a recent effort by the plaintiffs' bar to apply the Fair Debt Collection Practices Act to prevent the filing of certain types of claims in bankruptcy proceedings. The FDCPA was enacted in 1977, a year before the Code, as an amendment to the Consumer Credit Protection Act. See Pub. L. No. 95-109, 91 Stat. 874 (1977). In enacting the FDCPA, Congress sought, among other things, to "eliminate abusive debt collection practices," which it found "contribute to the number of personal bankruptcies." 15 U.S.C. 1692(a), (e). To achieve that end, the FDCPA bars debt collectors—defined broadly to include entities that "regularly collect[] or attempt[] to collect, directly or indirectly," debts owed to others, 15 U.S.C. 1692a(6)—from engaging in specified types of conduct.

Of particular relevance here, the FDCPA prohibits debt collectors from using "any false, deceptive, or misleading representation or means in connection with the

collection of any debt," including "false[ly] represent[ing] * * * the character, amount, or legal status of any debt." 15 U.S.C. 1692e. The FDCPA also prohibits debt collectors from using "unfair or unconscionable means to collect or attempt to collect any debt," including "collect[ing] * * * any amount" that is not "expressly * * * permitted by law." 15 U.S.C. 1692f. The FDCPA provides a private right of action for consumers against debt collectors. See 15 U.S.C. 1692k. Successful plaintiffs are entitled to actual damages and costs, including attorney's fees. See 15 U.S.C. 1692k(a). Regardless of the existence of actual damages, the FDCPA provides for statutory damages of up to $1,000 in an individual action or up to $500,000 in a class action. See 15 U.S.C. 1692k(a)(2).

B. Facts And Procedural History

1. In 2014, respondent filed a petition for bankruptcy in the United States Bankruptcy Court for the Southern District of Alabama under Chapter 13 of the Bankruptcy Code. Respondent was represented by counsel throughout the bankruptcy proceeding, and the bankruptcy court duly assigned a trustee to respondent's case. J.A. 9-10.

Petitioner had previously purchased a defaulted credit-card debt incurred by respondent in the amount of $1,879.71. Respondent did not list that debt in the schedule accompanying her bankruptcy petition. Petitioner subsequently filed a proof of claim for that debt in the bankruptcy proceeding. J.A. 12-19. As required by Bankruptcy Rule 3001, petitioner's proof of claim accurately listed the date of the last transaction on respondent's account as May 2003. J.A. 18. Respondent is an Alabama resident, and Alabama has a six-year limitations period for claims of the type at issue here. See Ala. Code § 6-2-34. The proof of claim was filed more than six years after

the last transaction on respondent's account. J.A. 15. Respondent's counsel objected to petitioner's claim on the ground that it lacked supporting documentation, J.A. 21, and the bankruptcy court disallowed it.[1]

Respondent's eligible assets were smaller than her debts. See Bankr. Ct. Dkt. 1, at 1 (Mar. 24, 2014). The bankruptcy court accordingly confirmed a non-100% repayment plan. See Bankr. Ct. Dkt. 42, at 1 (Sept. 15, 2014). Under such a plan—as in the majority of Chapter 13 cases and virtually all Chapter 7 cases—the amount the debtor pays depends on the debtor's projected income, not the total amount of the creditors' claims. See *In re Dubois*, 834 F.3d 522, 531-532 (4th Cir. 2016). Respondent's bankruptcy plan specified that she would pay $402 per month for 60 months, amounting to approximately 77% of her outstanding unsecured debts. See Bankr. Ct. Dkt. 42, at 1.

2. Three days after the bankruptcy court disallowed petitioner's claim, respondent brought a putative nationwide class action against petitioner in the United States District Court for the Southern District of Alabama under the FDCPA. J.A. 23-28. Respondent chose to file her FDCPA claim as a stand-alone action, rather than as an adversary proceeding within the bankruptcy case. The complaint in this case appears to have been a form complaint; respondent's counsel misspelled her first name as

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[1] Because respondent's counsel objected to the claim on the ground that it lacked supporting documentation (rather than on the ground that it was untimely), and because this case is before the Court on a motion to dismiss, the record does not reflect whether there was some reason the limitations defense would not apply: for example, because the defense had been waived, the limitations period tolled, or the claim revived by the debtor's subsequent conduct. For present purposes, the Court may assume that the claim would have been disallowed if respondent had raised a timeliness defense.

"Aledia" and erroneously referred to her as "him[]." J.A. 23, 26. The complaint alleged that, because petitioner's claim was for a time-barred debt, the filing of the proof of claim in respondent's bankruptcy proceeding constituted a deceptive, misleading, unfair, and unconscionable debt-collection practice under the FDCPA. J.A. 25. The complaint sought actual damages (although it did not allege any), as well as statutory damages, attorney's fees, and costs. *Ibid.* Despite the fact that respondent was still in bankruptcy, she did not seek to proceed *in forma pauperis*; instead, she (or someone on her behalf) paid the filing fee of $400. J.A. 5.

3. Petitioner moved to dismiss the suit, and the district court granted the motion. Pet. App. 18a-37a. The district court recognized that it was bound by the Eleventh Circuit's decision in *Crawford* v. *LVNV Funding, LLC*, 758 F.3d 1254 (2014), cert. denied, 135 S. Ct. 1844 (2015), which held that the filing of a proof of claim for a time-barred debt violates the FDCPA. Pet. App. 19a-20a. But the district court observed that the Eleventh Circuit had left open the related question whether the Code precludes such an application of the FDCPA. *Id.* at 20a.

The district court held that it does. Pet. App. 20a-37a. The court noted that, under Alabama law, the running of the limitations period does not extinguish a creditor's right to payment, but instead potentially eliminates the creditor's judicial remedy: namely, a civil judgment against the debtor. *Id.* at 22a. Analyzing the text of the Code, this Court's precedents, and bankruptcy practice, the district court determined that the Code permits a creditor to file a proof of claim for an unextinguished time-barred debt: that is, a debt on which the limitations period has run, but where the underlying right to payment continues to exist under state law. *Id.* at 21a-30a. The court then determined that there was an irreconcilable conflict

between the Code and the FDCPA, because "comply[ing] with the [FDCPA]" requires "surrendering [the creditor's] right under the Code." *Id.* at 33a. Accordingly, the court concluded that the earlier-enacted FDCPA "must give way" to the Code. *Id.* at 37a.

4. The court of appeals reversed and remanded. Pet. App. 1a-15a.[2]

The court of appeals first explained that it had decided a "nearly identical" question in *Crawford* and had held that "a debt collector violates the FDCPA when it files a proof of claim in a bankruptcy case on a debt that it knows to be time-barred." Pet. App. 2a, 5a. The court reaffirmed *Crawford*'s holding on that question. *Id.* at 5a-6a.

The court of appeals then turned to the related question it had expressly left open in *Crawford*: namely, whether the Bankruptcy Code "preclude[s] an FDCPA claim in the context of a Chapter 13 bankruptcy when a debt collector files a proof of claim it knows to be time-barred." Pet. App. 7a. At the outset, the court of appeals agreed with the district court that, under the Code, a creditor has a " 'right' to file a time-barred claim." *Id.* at 8a. The court explained that "the Code allows creditors to file proofs of claim that appear on their face to be barred by the statute of limitations." *Id.* at 7a.

The court of appeals nevertheless concluded that the Code "does not preclude an FDCPA claim in the bankruptcy context." Pet. App. 15a. The Code and the FDCPA could be "reconciled," according to the court, be-

[2] The court of appeals considered this case together with another case in which the same district court had subsequently relied on the reasoning of its decision in this case. See Pet. App. 4a. While the court of appeals addressed both cases in a single opinion, it entered separate judgments in each case. Only petitioner's case is before the Court.

cause the FDCPA "dictates the behavior of only 'debt collectors'" and because the Code "establishes the ability to file a proof of claim" while the FDCPA "addresses the later ramifications of filing a claim." *Id.* at 12a. The court reasoned that there was no "positive repugnancy" between the statutes, because a debt collector that files a proof of claim for a time-barred debt (as authorized under the Code) "is simply opening [itself] up to a potential lawsuit for an FDCPA violation." *Id.* at 14a (internal quotation marks omitted). In the court of appeals' view, subjecting conduct authorized by the Bankruptcy Code to civil liability under the FDCPA did not give rise to an irreconcilable conflict between the two statutes. *Id.* at 15a.

5. The court of appeals subsequently denied rehearing. Pet. App. 16a-17a.

SUMMARY OF ARGUMENT

A proof of claim is a creature of the Bankruptcy Code—a filing in a bankruptcy case defined and regulated by the Code and the accompanying rules. Of particular relevance here, the Code entitles a creditor that holds an unextinguished time-barred debt to file a proof of claim in the bankruptcy proceeding. The court of appeals erred by holding that the filing of such a proof of claim violates the FDCPA, and it further erred by holding that the Code does not preclude an application of the FDCPA that would prohibit such a filing.

I. As every court of appeals (including the Eleventh Circuit in the decision below) has correctly concluded, the Bankruptcy Code entitles a creditor such as petitioner to file a proof of claim for an unextinguished time-barred debt.

Under the Code, any creditor, including a debt collector, may file a proof of claim in the bankruptcy court when a debtor declares bankruptcy. In order to have a "claim"

for purposes of the Code, a creditor must have a "right to payment" under the relevant state law. Here, Alabama law (like the law of almost every other State) provides that the holder of a time-barred debt retains a right to payment. Accordingly, petitioner had a valid "claim" under the Code and was entitled to file a proof of claim for its debt.

Indeed, the Code expressly addresses the question of how a bankruptcy court should process a proof of claim for a time-barred debt. The Code seeks to bring all claims, whether enforceable or not, into the bankruptcy process in order to provide comprehensive resolution for the debtor. The Code also establishes a specific procedure for determining the allowability of claims, under which the trustee, assisted by other parties in interest, can raise objections on limitations or other grounds. Where those objections are sustained, the claim will be disallowed, with the result that it will not be paid by the estate and will ultimately be discharged.

What is more, the Federal Rules of Bankruptcy Procedure also address the filing of proofs of claim for time-barred debts. For claims involving certain types of consumer debt (including the type at issue here), Bankruptcy Rule 3001 requires a creditor to make disclosures that make it easy for the trustee and other parties in interest to raise timeliness objections. At the same time, the Bankruptcy Rules deliberately stop short of imposing an affirmative burden on creditors to identify limitations defenses in their proofs of claim.

This Court's cases, too, support the conclusion that the Code authorizes the filing of proofs of claim for time-barred debts. Those cases emphasize both the breadth of the Code's definition of "claim" and the breadth of States' authority to define creditors' underlying property rights,

even where a debt may not be recoverable via a monetary judgment in an action outside bankruptcy.

The inclusion of claims for time-barred debts within the Code's broad definition of "claim" is wholly consistent with the policies animating bankruptcy: most notably, the Code's core purpose of comprehensively bringing all of a debtor's debts into a single bankruptcy proceeding and resolving them. Excluding claims for time-barred debts would undermine the Code's operation by gutting its automatic-stay and discharge provisions—provisions that confer integral protections on debtors both during and after bankruptcy.

II. Filing a proof of claim for a time-barred debt, as authorized by the Code, does not violate the FDCPA.

The FDCPA prohibits debt collectors from using "any false, deceptive, or misleading representation or means in connection with the collection of any debt." 15 U.S.C. 1692e. A creditor does not violate Section 1692e by filing an accurate proof of claim for an unextinguished time-barred debt. Petitioner's proof of claim was entirely accurate, both in its factual content and in its implied representation that the debt collector had a "claim" under the Code. Under this Court's recent decision in *Sheriff* v. *Gillie*, 136 S. Ct. 1594 (2016), the filing of such a proof of claim did not violate Section 1692e.

Nor did such a filing violate the provision of the FDCPA that prohibits debt collectors from using "unfair or unconscionable means to collect or attempt to collect any debt." 15 U.S.C. 1692f. The bankruptcy process is replete with protections for a debtor, including the appointment of a trustee who is obligated to monitor proofs of claim and raise all necessary objections. The vast majority of debtors (like respondent here) have their own counsel as an additional layer of review. The creditor directs a proof of claim not at the debtor, but rather at the

bankruptcy estate, against whose assets the claim is being made. And an additional proof of claim, even if allowed, usually has no impact on a debtor's ultimate payments under the bankruptcy plan. There is therefore nothing unjust or unfair about the filing of a proof of claim for a time-barred debt.

Precisely because the allowance of a claim for a time-barred debt will ordinarily have no impact on the debtor, policing the filings of such proofs of claim in bankruptcy proceedings would assist only other creditors, not the consumers the FDCPA is designed to protect. And in practice, it would fuel already rampant litigation driven by the plaintiffs' bar for its own benefit. It would make little sense to stretch the language of the FDCPA to encompass the conduct at issue here.

III. Even if the FDCPA could be read to prohibit the filing of a proof of claim for a time-barred debt, the Bankruptcy Code would preclude that application of the FDCPA.

As an initial matter, this Court should interpret the FDCPA in such a way as to harmonize it with the Code. Assuming, *arguendo*, that the FDCPA is ambiguous on the question whether filing a proof of claim for a time-barred debt is prohibited, any ambiguity should be resolved against such an interpretation, because the Code expressly authorizes that very practice.

This Court's decision in *Kokoszka* v. *Belford*, 417 U.S. 642 (1974), is instructive. There, the Court held that a closely related consumer-protection statute could not be read to apply within bankruptcy. That holding counsels strongly in favor of a similar approach in interpreting the FDCPA. A contrary approach would disregard the Code's comprehensive scheme, its emphasis on uniformity, and its carefully tailored remedies for abusive or otherwise improper conduct in bankruptcy proceedings.

Finally, if the FDCPA were interpreted to prohibit the filing of a proof of claim for a time-barred debt, it would create an irreconcilable conflict with the Code. So read, the earlier-enacted FDCPA would prohibit what the later-enacted Code entitles a creditor to do. That conflict would suffice to repeal even clear statutory text, so it is plainly sufficient to preclude the judicial interpretation of the FDCPA that the Eleventh Circuit adopted here. It would be inconsistent with Congress's objective in expanding the definition of "claim" to construe an earlier-enacted, non-bankruptcy statute to limit the proofs of claim that can be filed in a bankruptcy proceeding.

In short, there is no valid justification for interpreting the FDCPA to prevent the filing of a proof of claim for a time-barred debt. The court of appeals' outlying interpretation is erroneous, and its judgment should therefore be reversed.

ARGUMENT

I. THE BANKRUPTCY CODE CREATES A RIGHT TO FILE A PROOF OF CLAIM FOR AN UNEXTINGUISHED TIME-BARRED DEBT IN A BANKRUPTCY PROCEEDING

As a threshold matter, the Bankruptcy Code plainly entitles a debt collector to file a proof of claim for an unextinguished time-barred debt. The Code gives every creditor, including a debt collector, the right to file a proof of claim when the debtor files for bankruptcy. A claim for an unextinguished time-barred debt qualifies as a "claim" under the Code, because the creditor has a right to payment under applicable state law. As a result, the Code confers a right to file a proof of claim for such a time-barred debt. That conclusion is so inescapable that every court of appeals to have considered the question, including the Eleventh Circuit in the decision below, has agreed

that the Code creates such a right. See *Dubois*, 834 F.3d at 529-530; *Owens* v. *LVNV Funding, LLC*, 832 F.3d 726, 730-734 (7th Cir. 2016), petition for cert. pending, No. 16-315 (filed Aug. 26, 2016); Pet. App. 8a-9a.

A. The Bankruptcy Code Defines A 'Claim' As A 'Right To Payment,' Which Includes The Right To Payment On An Unextinguished Time-Barred Debt

Under the Code, a creditor, including a debt collector, is entitled to file a proof of claim with the bankruptcy court when the debtor declares bankruptcy. 11 U.S.C. 501(a); see *Travelers*, 549 U.S. at 449. A "creditor" is defined simply as an "entity that has a claim against the debtor." 11 U.S.C. 101(10)(A). And a "proof of claim" is nothing more than a "written statement setting forth a creditor's claim." Fed. R. Bankr. P. 3001(a).

The Code defines a "claim" as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. 101(5)(A). By including that language in the Code, Congress "intended * * * to adopt the broadest available definition of 'claim.'" *Johnson*, 501 U.S. at 83. Congress sought to ensure that "all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case," with the result that the debtor can obtain the "broadest possible relief." H.R. Rep. No. 595, 95th Cong., 1st Sess. 309 (1977); see *Pennsylvania Department of Public Welfare* v. *Davenport*, 495 U.S. 552, 558 (1990); S. Rep. No. 989, 95th Cong., 2d Sess. 21-22 (1978).

It is a "settled principle" that "[c]reditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obliga-

tion." *Travelers*, 549 U.S. at 450 (quoting *Raleigh* v. *Illinois Department of Revenue*, 530 U.S. 15, 20 (2000)). Consistent with that principle, this Court has repeatedly recognized that, for purposes of the Code's definition of "claim," a "right to payment" exists where such a right is "recognized under state law." *Id.* at 451; see *Butner* v. *United States*, 440 U.S. 48, 54-55 (1979).

Under Alabama law, the relevant state law here, the running of a statutory limitations period does not "extinguish[]" the underlying "right" to payment; rather, it potentially eliminates a creditor's judicial remedy. *Ex parte Liberty National Life Insurance*, 825 So. 2d 758, 765 (Ala. 2002) (per curiam) (internal quotation marks and citation omitted). Indeed, because the running of the limitations period is an affirmative defense, Alabama courts will enter judgment for the creditor even on a time-barred claim where the debtor fails to raise the limitations defense at an appropriate time and thereby forfeits the defense. See, *e.g.*, *Ex parte Alabama ex rel. Ohio*, 718 So. 2d 669, 671 (Ala. 1998); *Oliver* v. *Dudley*, 109 So. 2d 668, 669 (Ala. 1959). Alabama law also allows a time-barred claim to be revived in certain circumstances: for example, where a debtor makes a partial payment on the debt or supplies a written promise to pay. See Ala. Code § 6-2-16; *Defco, Inc.* v. *Decatur Cylinder, Inc.*, 595 So. 2d 1329, 1333 (Ala. 1992). For present purposes, the critical point is that, regardless of the running of the limitations period, a creditor such as petitioner retains a right to payment on a time-barred debt under Alabama law.

Nor is Alabama law atypical in that respect. As this Court has recognized, it is the "traditional rule" that "expiration of the applicable statute of limitations merely bars the remedy and does not extinguish the substantive right." *Semtek International Inc.* v. *Lockheed Martin Corp.*, 531 U.S. 497, 504 (2001); see, *e.g.*, 51 Am. Jur. 2d

Limitation of Actions § 20 (West 2016). Almost all of the States adhere to that rule.[3] Because petitioner has a right to payment under applicable state law, it necessarily follows under the Code's definition of "claim" that petitioner was entitled to file a proof of claim in respondent's bankruptcy proceeding.

B. The Bankruptcy Code Invites The Filing Of Proofs Of Claim For Unextinguished Time-Barred Debts

Beyond its definition of "claim," the Code generally invites the filing of proofs of claim for rights that are not enforceable, and specifically contemplates the filing of proofs of claim for unextinguished time-barred debts.

1. The Code expressly brings claims that are not presently enforceable into the bankruptcy proceeding. As examples of "claims," the Code cites rights to payment that are "contingent," "unmatured," or "disputed." 11 U.S.C. 101(5)(A). Neither contingent nor unmatured claims are presently enforceable. See *In re Rosteck*, 899 F.2d 694, 697 (7th Cir. 1990) (describing a "contingent" claim as one that "depend[s] on future uncertain events"); *In re Camp*, 78 B.R. 58, 63 n.6 (Bankr. E.D. Pa. 1987) (describing an "unmatured" claim as one where "the right to payment exists at the outset, but the time of payment is deferred" (citation omitted)). And the same is true for at least some disputed claims: namely, those where a debtor's reasons for disputing the claim turn out to be valid.

The Code also establishes a specific process for determining the allowability of claims: that is, for resolving de-

[3] We are aware of only two States, Mississippi and Wisconsin, where the expiration of the limitations period extinguishes not just the remedy but also the underlying right to payment. See Miss. Code Ann. § 15-1-3(1); Wis. Stat. Ann. § 893.05.

fenses to claims, including limitations defenses. In consumer bankruptcies, the Code provides for the appointment of a trustee, who is required to examine proofs of claim and object, as needed, to any claim that is improper. See 11 U.S.C. 704(a)(5), 1302(b)(1). By default, most claims are deemed allowed unless the trustee or some other party in interest objects. See 11 U.S.C. 502(a), (d), (e).

Upon an objection, the bankruptcy court must determine whether the claim should be disallowed under any of the exceptions listed in the Code: for example, if a defense renders the claim "unenforceable against the debtor and property of the debtor." 11 U.S.C. 502(b)(1). The Code specifically provides that "[t]he [bankruptcy] estate shall have the benefit of any defense available to the debtor as against any entity other than the estate, *including statutes of limitation*." 11 U.S.C. 558 (emphasis added). The Code thus invites claims for time-barred debts to be brought into the bankruptcy process; where the trustee or another party in interest raises a valid objection on limitations grounds, the claim will be disallowed, with the result that it will not be paid by the estate and will ultimately be discharged.

Notably, a limitations objection will not always be successful. Statutes of limitations generally provide affirmative defenses that are subject to forfeiture, tolling, and revival, all of which would make a seemingly time-barred debt enforceable. See, *e.g.*, 54 C.J.S. *Limitations of Actions* § 133, at 150 (2010); 51 Am. Jur. 2d *Limitation of Actions* § 16; *Shepherd* v. *Thompson*, 122 U.S. 231, 235 (1887); Ala. Code § 6-2-16. For present purposes, the key point is that the Code establishes that a limitations defense (like any other defense) will be raised, and if necessary litigated, *in response to* the filing of a proof of claim

for a potentially time-barred debt. See 11 U.S.C. 502(a), (b)(1), 558.

2. The Federal Rules of Bankruptcy Procedure also address the filing of proofs of claim for time-barred debts. For claims involving certain types of consumer debt (including the type at issue here), Bankruptcy Rule 3001 requires a creditor to include certain information in the proof of claim, including the date of the account holder's last transaction; the date of the last payment on the account; and the date the account was charged to profit and loss. See Fed. R. Bankr. P. 3001(c)(3)(A). Those additional disclosures were mandated precisely for the purpose of enabling parties in interest to "assess[] the timeliness of the claim." Fed. R. Bankr. P. 3001 advisory committee's notes (2012); see *Agenda Book for the Meeting of the Advisory Committee on Bankruptcy Rules* 86-87, 90 (Mar. 26-27, 2009) (*Agenda Book*) <tinyurl.com/2009-agenda>. And the failure to supply the required information exposes a creditor to sanctions, including the payment of attorney's fees and other expenses "caused by the failure." Fed. R. Bankr. P. 3001(c)(2)(D). Consistent with the Code, therefore, the Bankruptcy Rules authorize the filing of proofs of claim for time-barred debts, but provide protections to ensure that objections to such claims can be made with minimal burden.

Critically, when it proposed adding the disclosure requirements to Bankruptcy Rule 3001, a working group of the Advisory Committee on Rules of Bankruptcy Procedure considered going further and requiring creditors affirmatively to "state whether the claim is timely under the relevant statute of limitations." *Agenda Book* 86. But it stopped short of such a requirement, instead recommending that creditors supply the factual information that would allow parties in interest to raise timeliness objec-

tions "more easily." *Id.* at 86-87. The Advisory Committee adopted that reasoning and rejected the affirmative certification requirement. See *Minutes for the Meeting of the Advisory Committee on Bankruptcy Rules* 9 (Mar. 26-27, 2009) <tinyurl.com/2009minutes>. By devising specific procedures for the filing of proofs of claim for time-barred debts, the Advisory Committee obviously contemplated that such proofs of claim would be filed.[4]

3. This Court's cases on the scope of bankruptcy proceedings support the conclusion that the Code authorizes the filing of proofs of claim for time-barred debts. Those cases emphasize both the breadth of the Code's definition of "claim" and the breadth of States' authority to define creditors' underlying property rights. See, *e.g.*, *Travelers*, 549 U.S. at 449-451; *Grogan*, 498 U.S. at 283; *Davenport*, 495 U.S. at 558-559; *Butner*, 440 U.S. at 54-55; *Bryant* v. *Swofford Brothers Dry Goods*, 214 U.S. 279, 290-291 (1909).

This Court's decision in *Davenport* is illustrative. There, the Court considered whether a right to restitution payments from criminal offenders who declared bankruptcy constituted a "claim" for purposes of the Code. Although the probation department could revoke the debtors' probation if they missed their payments, neither the probation department nor the victim had a civil cause of action to recover the unpaid sums (and there was thus no way to obtain a monetary judgment for those sums). See 495 U.S. at 558-559. The Court nevertheless held that

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[4] Because the Bankruptcy Code expressly authorizes the filing of proofs of claim for time-barred debts, it necessarily follows that such a filing is not sanctionable under Bankruptcy Rule 9011 simply because a limitations defense is available. The Advisory Committee's decision to require only factual disclosures, rather than a certification about the claim's timeliness, underscores the point. See *Agenda Book* 86.

the probation department and the victim had a "right to payment," and thus a "claim," under the Code. See *id.* at 558-560. In so holding, the Court emphasized "Congress' broad rather than restrictive view of the class of obligations that qualify as a 'claim.'" *Id.* at 558. *Davenport* thus stands for the proposition that a "claim" can exist under the Code regardless of the creditor's ability to obtain a monetary judgment in an action outside bankruptcy.

To be sure, in *Davenport*, the Court also stated that a "claim" is "nothing more nor less than an enforceable obligation, regardless of the objectives the State seeks to serve in imposing the obligation." 495 U.S. at 559. But precisely because the obligation at issue in *Davenport* was enforceable, albeit through a means other than a monetary judgment, the Court was not purporting to create a rule excluding "unenforceable" obligations from the scope of the term "claim." Instead, the Court was merely clarifying that "[neither] the purpose [n]or enforcement mechanism" of an obligation could *limit* its status as a "claim." *Id.* at 560.[5] And excluding "unenforceable" obligations from the definition of "claim" would conflict with the plain language of the Code, which expressly sweeps in claims that are not presently enforceable (such as "contingent" and "unmatured" claims) and instructs how those claims should be processed. See pp. 18-19, *supra*.

[5] To the extent this Court has quoted the foregoing language from *Davenport* in subsequent cases, it has done so to emphasize the *breadth* of the term "claim," not to narrow it. See *NextWave*, 537 U.S. at 302-303; *Cohen* v. *de la Cruz*, 523 U.S. 213, 218 (1998); *Johnson*, 501 U.S. at 83-84.

C. Including Claims For Time-Barred Debts Within The Code's Broad Definition Of 'Claim' Serves The Code's Key Policies

The inclusion of claims for time-barred debts within the Code's broad definition of "claim" is wholly consistent with the policies animating bankruptcy. After all, "[a] fundamental principle of the bankruptcy process is the collective treatment of all of a debtor's creditors at one time." 1 William L. Norton Jr. & William L. Norton III, *Norton Bankruptcy Law and Practice* § 3:9, at 3-17 (3d ed. 2016); see, *e.g.*, *In re Glenn*, 542 B.R. 833, 841 (Bankr. N.D. Ill. 2016) (observing that, "[t]he more participation there is[,] the better [the bankruptcy] process works"). A contrary interpretation would erode the protections and benefits that bankruptcy provides to debtors.

1. Excluding claims for time-barred debts from the definition of "claim" would eliminate one of the Code's core protections for debtors: the automatic-stay provision that prevents creditors from taking any act to "collect, assess, or recover a [preexisting] claim against the debtor." 11 U.S.C. 362(a)(6). In adopting that provision, Congress sought to protect "[i]nexperienced, frightened, or ill-counseled debtors" from conduct that could lead them to "succumb to suggestions to repay [a preexisting debt] notwithstanding their bankruptcy." H.R. Rep. No. 595, *supra*, at 342.

If claims for time-barred debts do not qualify as "claims" under the Code, the foregoing provision, which by its terms governs only efforts to collect "claim[s] against the debtor," would not apply to those debts. A creditor could thus continue to contact a debtor during the bankruptcy in an effort to get the debtor to repay all or some of the debt (or to take some other action that would revive the claim). Such a regime would strip the debtor of

the repose a declaration of bankruptcy is supposed to provide, and it could conceivably result in payment to a holder of time-barred debt at the expense of the estate (thus contravening the Code's goal of preserving the estate for equitable division among all of the creditors). See 3 *Collier on Bankruptcy* ¶ 362.03, at 362-23 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2016) (*Collier on Bankruptcy*).

2. Excluding claims for time-barred debts from the definition of "claim" would also limit the benefits to the debtor from discharge—widely understood to be the "principal advantage" of bankruptcy in the first place. Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 Harv. L. Rev. 1393, 1393 (1985). A discharge in bankruptcy applies only to a debtor's "debts." See 11 U.S.C. 727(b), 1328(a). A "debt," in turn, is "liability on a claim" as defined by the Code. 11 U.S.C. 101(12). It necessarily follows that, if claims for time-barred debts do not constitute "claims" for purposes of the Code, those debts cannot be discharged.

In light of the Bankruptcy Code's ultimate goal of granting debtors a "fresh start," *Marrama*, 549 U.S. at 367 (internal quotation marks and citation omitted), it is fundamental to the Code's operation that all of a debtor's debts are brought into the bankruptcy proceeding in order to ensure that they are discharged. It was for that reason that Congress gave the term "claim" such an expansive definition in the Code. See *Davenport*, 495 U.S. at 558; H.R. Rep. No. 595, *supra*, at 309. There is no valid justification to construe the term "claim" so as to exclude claims for time-barred debts.

The inability to discharge time-barred debts would harm debtors in multiple ways. First, a discharge acts as a continuing injunction against any "act[] to collect" the debt. 11 U.S.C. 524(a)(2). Absent a discharge, a creditor

could continue contacting the debtor through phone calls and letters in an effort to collect. See, *e.g.*, *Owens*, 832 F.3d at 732 & n.6; Federal Trade Commission, *Consumer Information: Time-Barred Debts* (July 2013) (*Consumer Information*) <tinyurl.com/ftcinformation>; Federal Trade Commission, *Repairing a Broken System: Protecting Consumers in Debt Collection Litigation and Arbitration* 22-23 (July 2010) (*Repairing a Broken System*) <tinyurl.com/ftcdebtcollection>. Second, a discharge extinguishes the debt nationwide, whereas statutes of limitations vary from State to State. See 54 C.J.S. *Limitations of Actions* § 20, at 38. Unless a time-barred debt is discharged, a creditor could potentially collect on the debt by filing a lawsuit in a State with a longer limitations period and no "borrowing" statute. See 1 Restatement (Second) of Conflict of Laws §§ 142(2) & cmt. f, 143 & cmt. a, at 396-397, 400 (1971). Third, a discharge ensures that the debtor receives the full benefits of a fresh start, including protection from various forms of discrimination based on the nonpayment of the debt. See 11 U.S.C. 525.

In sum, the Bankruptcy Code sweeps claims for time-barred debts within its broad definition of "claim," and the Code, together with the accompanying rules, establishes a process for resolving these claims easily and expeditiously. Because petitioner has a right to payment under applicable state law, it possessed a "claim" and thus was entitled to file a proof of claim in respondent's bankruptcy proceeding.

II. THE FDCPA DOES NOT PROHIBIT FILING A PROOF OF CLAIM FOR AN UNEXTINGUISHED TIME-BARRED DEBT IN A BANKRUPTCY PROCEEDING

Petitioner did not violate the FDCPA by filing a proof of claim on an unextinguished time-barred debt, as authorized by the Bankruptcy Code. The FDCPA prohibits

debt collectors from using "any false, deceptive, or misleading representation or means in connection with the collection of any debt," 15 U.S.C. 1692e, or from using "unfair or unconscionable means to collect or attempt to collect any debt," 15 U.S.C. 1692f. Filing a proof of claim on an unextinguished time-barred debt pursuant to the Code does not violate either of those prohibitions. Petitioner's proof of claim accurately presented all of the facts required by the Bankruptcy Rules to enable parties in interest to assess the claim's timeliness. Nor is there anything unfair or unconscionable about filing an accurate proof of claim in the bankruptcy process, which is replete with protections for the debtor. And it would be far removed from the core purposes of the FDCPA to extend that statute to regulate the filing of proofs of claim in bankruptcy proceedings.

For those reasons, every court of appeals to consider this question, with the exception of the Eleventh Circuit, has concluded that the FDCPA does not prohibit filing a proof of claim for an unextinguished time-barred debt in a bankruptcy proceeding. Compare *Dubois*, 834 F.3d at 533; *Owens*, 832 F.3d at 736-737; *Nelson* v. *Midland Credit Management, Inc.*, 828 F.3d 749, 752 (8th Cir. 2016), with Pet. App. 5a-6a. This Court should now reach the same conclusion.

A. Filing A Factually Accurate Proof Of Claim For An Unextinguished Time-Barred Debt In A Bankruptcy Proceeding Does Not Violate Section 1692e

To begin with, petitioner did not violate Section 1692e by filing a proof of claim on an unextinguished time-barred debt. That provision prohibits debt collectors from using "any false, deceptive, or misleading representation or means in connection with the collection of any debt." 15 U.S.C. 1692e. It proceeds to list sixteen non-

exclusive categories of conduct qualifying as false or misleading, including "false[ly] represent[ing] * * * the character, amount, or legal status of any debt." *Ibid.*

1. This Court interpreted Section 1692e just a few months ago in *Sheriff* v. *Gillie*, 136 S. Ct. 1594 (2016). In that case, a state attorney general appointed private attorneys to collect a debt on his behalf; those attorneys used the attorney general's letterhead on letters seeking to collect those debts. See *id.* at 1598-1599. The letters disclosed that the attorneys were debt collectors and included the attorneys' contact information in the signature block. See *id.* at 1599. The debtors sued the attorneys, contending that their use of the attorney general's letterhead violated Section 1692e. See *id.* at 1598.

The Court unanimously rejected the debtors' claim, holding that the use of the letterhead was accurate and thus not "false" or "misleading" for purposes of Section 1692e. See 136 S. Ct. at 1601. The Court reasoned that the letterhead correctly identified the principal for whom the attorneys were acting as agents. See *ibid.* Neither debtors' fear that the attorney general might take punitive action against them, nor debtors' doubts about the authenticity of the letters, altered the Court's analysis. See *id.* at 1602-1603. As the Court explained, "[Section] 1692e bars debt collectors from deceiving or misleading consumers; it does not protect consumers from fearing the actual consequences of their debts." *Id.* at 1603.

Like the letters in *Sheriff*, petitioner's proof of claim here was entirely accurate and in no way misleading. The proof of claim contained all the information required by Bankruptcy Rule 3001, including the date of the account holder's last transaction, the date of the last payment on the account, and the date the account was charged to profit and loss. J.A. 18. It is undisputed that petitioner

made the required disclosures and that it did so correctly and completely.

Petitioner's proof of claim was equally accurate with regard to the "legal status" of the debt. 15 U.S.C. 1692e(2)(A). As required by the Bankruptcy Rules, petitioner used a standard form for its filing. See Fed. R. Bankr. P. 3001(a), 9009. Petitioner made no affirmative representation concerning the legal status of the debt other than the preprinted notation "PROOF OF CLAIM" at the top of the form. J.A. 12. That notation indicated petitioner's good-faith belief that it had a claim—that is, a right to payment—regardless of whether the right was ultimately enforceable. See 11 U.S.C. 101(5)(A). Because petitioner did in fact have a right to payment under Alabama law and thus under the Code, see pp. 16-17, *supra*, petitioner's belief was well founded.

Petitioner was under no obligation affirmatively to state that the claim was timely (or to make any representations concerning other possible defenses). Indeed, the Advisory Committee deliberately chose not to require creditors to make such a statement. See pp. 20-21, *supra*. Consistent with the requirements the Advisory Committee actually adopted in the Bankruptcy Rules, the proof-of-claim form did not ask petitioner to express its view as to whether the claim was subject to a limitations defense, but instead merely required petitioner to make certain factual disclosures so as to enable parties in interest to assess the claim's timeliness. Because petitioner accurately made those disclosures, the proof of claim was not "false" or "misleading," and it therefore did not violate Section 1692e.

2. As in *Sheriff*, because petitioner's proof of claim was accurate by any standard, this Court need not consider the question of whose perspective is relevant in adjudging a potentially false or misleading statement. See

Sheriff, 136 S. Ct. at 1602 n.6 (reserving the question). In this context, however, the applicable standard confirms the conclusion that petitioner did not violate Section 1692e by filing its proof of claim.

Generally, whether a communication is false or misleading is measured by reference to its intended recipient. See, *e.g.*, *Bates* v. *State Bar of Arizona*, 433 U.S. 350, 383 n.37 (1977). Thus, for purposes of applying the FDCPA to communications directly to a debtor, courts of appeals generally assess those communications from the perspective of an unsophisticated consumer (albeit with slightly varying formulations). See, *e.g.*, *Fouts* v. *Express Recovery Services, Inc.*, 602 Fed. Appx. 417, 421 (10th Cir. 2015); *Peters* v. *General Service Bureau, Inc.*, 277 F.3d 1051, 1055 (8th Cir. 2002); *Gammon* v. *GC Services Limited Partnership*, 27 F.3d 1254, 1257 (7th Cir. 1994). By contrast, in cases involving communications to a debtor's attorney (or to a debtor represented by an attorney), several courts of appeals analyze those communications from the perspective of a competent attorney. See, *e.g.*, *Bravo* v. *Midland Credit Management, Inc.*, 812 F.3d 599, 603 (7th Cir. 2016); *Powers* v. *Credit Management Services, Inc.*, 776 F.3d 567, 573-574 (8th Cir. 2015); *Dikeman* v. *National Educators, Inc.*, 81 F.3d 949, 953-954 (10th Cir. 1996).

So too here, the applicable standard should turn on the intended recipient of the proof of claim. And a proof of claim filed in a bankruptcy proceeding dramatically differs from a letter sent to a debtor—or even a lawsuit filed against the debtor outside bankruptcy. A proof of claim is directed not at the debtor, but rather at the bankruptcy estate, against whose assets the claim is being made. See 11 U.S.C. 726(a); *Travelers*, 549 U.S. at 449. In bankruptcy proceedings, a trustee is assigned to each case, and it is the trustee's duty, where appropriate, to "examine

proofs of claims and object to the allowance of any claim that is improper." 11 U.S.C. 704(a)(5); see 11 U.S.C. 1302 (b)(1). In addition, the overwhelming majority of debtors—like respondent here—are represented by counsel. See Administrative Office of the United States Courts, *Bankruptcy Cases Filed by Pro Se Debtors, by Chapter, During the 12-Month Period Ending September 30, 2016*, tbl. F-28 (noting that 91.3% of debtors in Chapter 13 cases and 91.1% of debtors in Chapter 7 cases have counsel).

As a practical matter, therefore, the intended recipients of a proof of claim are the trustee, the counsel for the debtor, and the other parties in interest (including other creditors). In the rare case where a debtor is proceeding pro se, the debtor need not do anything in response to a proof of claim, because a trustee's objection—which the trustee is obligated to make, where appropriate—is sufficient for the claim to be disallowed. See 11 U.S.C. 502(a), (b). And as explained below, see pp. 35-36, an additional proof of claim, even if allowed, usually has no impact on a debtor's ultimate payments under the bankruptcy plan. Accordingly, for purposes of applying the FDCPA to a proof of claim in a bankruptcy proceeding, a court should analyze any alleged misrepresentation from the perspective of a competent trustee or attorney.

For all of the reasons set out above, a competent trustee or attorney would not be misled by a proof of claim that, like the claim at issue here, accurately discloses the required information so as to enable the parties in interest to assess the claim's timeliness. Particularly under the correct standard for measuring the accuracy of a proof of claim, this is not a close case. Because petitioner's proof of claim was in no respect "false" or "misleading," it did not violate Section 1692e.

B. Filing A Factually Accurate Proof Of Claim For An Unextinguished Time-Barred Debt In A Bankruptcy Proceeding Does Not Violate Section 1692f

For similar reasons, petitioner did not violate Section 1692f by filing a proof of claim on an unextinguished time-barred debt. That provision prohibits debt collectors from using "unfair or unconscionable means to collect or attempt to collect any debt." 15 U.S.C. 1692f. As is relevant here, "unfair" conduct is conduct that is "[n]ot honest" or is "unjust." *Black's Law Dictionary* 1760 (10th ed. 2014). "Unconscionable" conduct is conduct that "show[s] no regard for conscience" and "affront[s] the sense of justice, decency, or reasonableness" or is "[s]hockingly unjust or unfair." *Id.* at 1757.

1. As we have just explained, there is nothing dishonest about filing an accurate proof of claim for an unextinguished time-barred debt in a bankruptcy proceeding. And submitting such a filing—a type of filing that the Bankruptcy Code invites creditors to make—is a far cry from conduct that offends the sense of justice. Such a filing bears no resemblance to the intimidating and coercive conduct that motivated the FDCPA's enactment, such as threatening or harassing consumers, sending phony legal documents, and impersonating attorneys. See H.R. Rep. No. 1202, 94th Cong., 2d Sess. 2 (1976).

Unlike consumers who are the target of traditional debt-collection activity, debtors in bankruptcy are protected by a panoply of procedures. Every consumer bankruptcy case is assigned a trustee who is obligated to monitor proofs of claim and raise all necessary objections, and the vast majority of debtors (like respondent here) have their own counsel as an additional layer of protection. See pp. 29-30, *supra*. In addition, the claims process is highly regulated: the Code and accompanying rules establish a procedure for handling proofs of claim, require proofs of

claim to contain certain information, and prescribe sanctions for abusive or otherwise improper conduct. See, *e.g.*, 11 U.S.C. 105(a); Fed. R. Bankr. P. 3001, 3002, 3004, 3007, 9011.

Of particular relevance here, objecting to a proof of claim is a simple step that imposes only a minimal burden, as illustrated by the one-sentence objection respondent's attorney filed in response to petitioner's claim. J.A. 21; see Fed. R. Bankr. P. 3007(a) (providing that an objection need only be "in writing"). Unlike a debtor faced with defending an improper civil action brought by a debt collector or responding to a communication from a debt collector outside the legal process, a debtor in bankruptcy does not have to assemble the key facts and supporting documentation relating to the debt's timeliness. Instead, in cases such as this one, the Bankruptcy Rules place the onus on the creditor advancing the claim to maintain the relevant documentation and expend the effort of collecting and presenting those facts in the first instance. See Fed. R. Bankr. P. 3001(c)(3)(A). The rules even empower the debtor to seek additional documentation from the creditor. See Fed. R. Bankr. P. 3001(c)(3)(B).

A debtor in bankruptcy is also protected by the automatic stay, which ensures that a creditor cannot take any sort of action to collect on a preexisting claim, such as calling a debtor or sending the debtor letters in an effort to obtain a payment. See 11 U.S.C. 362(a)(6). The stay provides "breathing space" for the debtor, eliminating the potentially coercive pressures that debtors face outside the bankruptcy process. 3 *Collier on Bankruptcy* ¶ 362.03, at 362-23.

Further decreasing any intimidation or coercion, a creditor directs a proof of claim not at the debtor, but rather at the bankruptcy estate, against whose assets the claim is being made. See 11 U.S.C. 726(a); *Travelers*, 549

U.S. at 449. In most cases, the proof of claim will be filed on the docket and reviewed by the debtor's attorney; the debtor may not even see it. And as explained below, see p. 35, an additional proof of claim, even if allowed, usually has no impact on a debtor's ultimate payments under the bankruptcy plan. The filing of a proof of claim is thus far less direct, and far less likely to be intimidating and coercive, than the types of traditional debt-collection activity directed at the debtor and regulated by the FDCPA.

What is more, to the extent the FDCPA seeks to protect debtors from the embarrassment of the public airing of their debts, see, *e.g.*, 15 U.S.C. 1692c(b), 1692f(7), (8); S. Rep. No. 382, 95th Cong., 1st Sess. 4 (1977), debtors who take advantage of the bankruptcy process have already chosen to make public the fact of their debts and much of their financial information. See 11 U.S.C. 107(a); *Greene* v. *Taylor*, 132 U.S. 415, 443 (1889). In addition, because debtors choose the forum and are likely to have voluntarily initiated the proceedings, debtors are far less vulnerable inside the bankruptcy process than they would be outside it.

Finally on this score, at the conclusion of the bankruptcy process, a debt is discharged regardless of whether the corresponding claim is allowed. As discussed above, see pp. 24-25, discharge provides a debtor with broad protection from any future acts to recover the debt, as well as from various forms of discrimination based on the nonpayment of that debt. See 11 U.S.C. 524(a), 525. Even if the claim is disallowed, therefore, the inclusion of the debt in the bankruptcy process gives the debtor the fresh start contemplated by the Bankruptcy Code. See *Grogan*, 498 U.S. at 286. For all of those reasons, in addition to being accurate, a proof of claim for time-barred debt is neither unjust nor unfair.

2. Nor is it unjust or unfair that, if the trustee and the other parties in interest all fail to object, a proof of claim for an unextinguished time-barred debt could result in a payment that could have been avoided by the filing of an objection. A creditor, including a debt collector, has a right to payment on an unextinguished debt, even if it is subject to a limitations defense. See pp. 16-18, *supra*. Debt collectors may thus seek repayment on time-barred debt in various ways without violating the FDCPA, including by encouraging a debtor to make partial payment or to acknowledge the debt, or by otherwise seeking to revive a time-barred claim. See *Owens*, 832 F.3d at 732 & n.6; *Repairing a Broken System* 22-23. Just as debt collectors are within their rights to take actions directed at debtors in an effort to obtain repayment, so too are they within their rights in seeking to recover via the more indirect step of filing a proof of claim in a bankruptcy proceeding.

C. Filing A Factually Accurate Proof Of Claim For An Unextinguished Time-Barred Debt Has Little If Any Impact On A Debtor And Does Not Implicate The FDCPA's Purposes

Reading either Section 1692e or Section 1692f to bar the filing of a proof of claim for an unextinguished time-barred debt would be especially odd because a proof of claim has little if any effect on the consumers the FDCPA is meant to protect.

1. Debt recovery within bankruptcy is fundamentally different from debt collection outside bankruptcy. As discussed above, a creditor in bankruptcy makes a claim not against the debtor's assets, but against the assets of the bankruptcy estate. See p. 29, *supra*. The allowance of a claim thus affects how the assets of the estate will be divided among the creditors. While the Code provides debt-

ors with numerous protections, the claims-allowance process exists primarily to ensure fairness to *creditors*. See, *e.g.*, *Gardner* v. *New Jersey*, 329 U.S. 565, 573 (1947). To the extent the filing of a proof of claim affects a debtor at all, it will often be affirmatively beneficial, because it ensures discharge of the debt (where, as here, the debtor has failed to list the debt on the schedule accompanying the bankruptcy petition). See 11 U.S.C. 523(a)(3)(A), 1328 (c)(2). The Code even permits the debtor to file a proof of claim on behalf of a creditor that has failed to do so. See 11 U.S.C. 501(c); Fed. R. Bankr. P. 3004.

In the event a claim for a time-barred debt is ultimately allowed, moreover, it will ordinarily have no effect on the debtor. Congress "clearly contemplated [C]hapter 13 plans paying little or nothing on unsecured debts," and unsecured claims may be discharged even if the debtor "pay[s] nothing to unsecured claimants." 8 *Collier on Bankruptcy* ¶ 1328.02[3][a], at 1328-13. In most Chapter 13 cases (and virtually all Chapter 7 cases),[6] debtors pay back less than 100% of their unsecured debts—which is understandable, since debtors who can afford to pay back all of their unsecured debts generally do not need to enter bankruptcy in the first place. See *Dubois*, 834 F.3d at 531-532. In the typical Chapter 13 case, the amount the debtor pays depends on the debtor's projected income—with the result that an additional allowed claim decreases the amount available to pay other creditors, rather than increasing the amount paid by the debtor. See *ibid.* That was the case here: the bankruptcy court ultimately confirmed a repayment plan under which respondent would

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[6] In a Chapter 7 case, the allowance of an additional proof of claim generally has no effect on the debtor, because the debtor lacks any pecuniary interest in the estate. See 4 *Collier on Bankruptcy* ¶ 502.02 [2][c], at 502-13.

pay $402 per month for 60 months, amounting to approximately 77% of her outstanding unsecured debts. See p. 8, *supra*.[7]

Policing the filing of proofs of claim thus primarily affects the interests of other creditors. If anything, it is those creditors, not the debtor, that should have every incentive to object to claims they believe should be disallowed. The Bankruptcy Code plainly confers the right to object on creditors as parties in interest, 11 U.S.C. 502(a)—and, as sophisticated parties, they are more than able to protect their rights by doing so. And at the risk of stating the obvious, the FDCPA exists to protect the interests of consumers, not creditors. See 15 U.S.C. 1692(a), (b), (e), 1692a(3); S. Rep. No. 382, *supra*, at 1-2. Nothing in the text or legislative history of the FDCPA

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[7] Indeed, in light of the foregoing circumstances, respondent has not identified a concrete injury sufficient to establish Article III standing. J.A. 23-28; see *Spokeo, Inc.* v. *Robins*, 136 S. Ct. 1540, 1548 (2016). Because petitioner's claim was disallowed, respondent did not have to make any payment on it. But even if the claim had been allowed, it would not have affected respondent, because allowance would not have altered the amount she was required to pay; each creditor simply received a *pro rata* share of the total pool of available assets. Respondent does not allege that she incurred any cost from her bankruptcy attorney's filing the one-sentence objection to petitioner's claim; to the contrary, it appears that respondent paid her attorney a flat fee for his services in the bankruptcy proceeding. Bankr. Ct. Dkt. 2, at 2 (Mar. 24, 2014); see Lois R. Lupica, *The Consumer Bankruptcy Fee Study: Final Report*, 20 Am. Bankr. Inst. L. Rev. 17, 80 (2012) (noting that most bankruptcy attorneys are paid on a flat-fee basis). As a result, respondent has failed to establish any injury that "actually exist[s]," and she thus lacks standing to proceed with her FDCPA suit. *Spokeo*, 136 S. Ct. at 1548.

evinces an intention to govern the division of a bankruptcy estate among creditors.[8]

2. Because the filing of a proof of claim for a time-barred debt has little if any impact on a debtor, the primary beneficiaries of extending the FDCPA to that conduct would be plaintiffs' lawyers looking for technical violations of the statute in the hope of obtaining attorney's fees. This case appears to be a prime example of such lawyer-driven litigation. After respondent's bankruptcy attorney filed a one-sentence objection to petitioner's proof of claim, the bankruptcy court disallowed the claim. J.A. 9-10. Respondent thus suffered no actual injury. Yet just three days later, another attorney filed a putative nationwide class action on respondent's behalf, using what appears to have been a form complaint. J.A. 5, 23-28.

The Court should not endorse this pernicious practice. For years, courts have expressed concern about the "cottage industry" of litigation that has arisen under the FDCPA. See, *e.g.*, *Federal Home Loan Mortgage Corp.* v. *Lamar*, 503 F.3d 504, 513 (6th Cir. 2007). In fact, there has been an explosion of litigation under the FDCPA in the last few years alone: approximately 11,000 plaintiffs filed FDCPA cases in 2015, up from approximately 4,000

[8] To be sure, the FDCPA seeks not only to "eliminate abusive debt collection practices by debt collectors," but also to "insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged." 15 U.S.C. 1692(e). In both respects, however, the FDCPA ultimately seeks to encourage good debt-collection practices *for the benefit of the consumer*. See H.R. Rep. No. 1202, *supra*, at 5 (stating that the "object" of the FDCPA is to "protect consumers by encouraging all debt collectors to adopt an honest and ethical standard of conduct"). Any harm to one debt collector from an improperly allowed proof of claim filed by another is far removed from this concern—especially because that harm would result from the first debt collector's own failure to file an objection to the proof of claim. See 11 U.S.C. 502(a).

plaintiffs in 2007. See Consumer Financial Protection Bureau, *Fair Debt Collection Practices Act: CFPB Annual Report* 15 (Mar. 2016) <tinyurl.com/cfpbannualreport>; WebRecon LLC, *Out Like a Lion … Debt Collection Litigation & CFPB Complaint Statistics, Dec. 2015 & Year in Review* (last visited Nov. 11, 2016) <tinyurl.com/webreconyearinreview>. A disproportionate number of those cases are brought by the same small group of attorneys. See, *e.g.*, WebRecon LLC, *Do You Remember … When September Was Still Unpredictable? Debt Collection Litigation & CFPB Complaint Stats, Sept. 2016* (last visited Nov. 11, 2016) <tinyurl.com/webreconsept2016>.

Federal statutes should not be construed for the benefit of rapacious attorneys. Yet allowing FDCPA suits for filing proofs of claim for time-barred debts would primarily serve the plaintiffs' bar, rather than the consumers the FDCPA is meant to protect. Consistent with the plain language of the statute, this Court should reject the court of appeals' outlying interpretation and hold that the FDCPA does not reach the filing of a proof of claim for an unextinguished time-barred debt.

III. TO THE EXTENT THE FDCPA COULD BE READ TO PROHIBIT FILING A PROOF OF CLAIM FOR AN UNEXTINGUISHED TIME-BARRED DEBT, THE BANKRUPTCY CODE PRECLUDES SUCH APPLICATION OF THE FDCPA

Even if the FDCPA could be read to prohibit the filing of a proof of claim for an unextinguished time-barred debt, the Bankruptcy Code would preclude that application of the FDCPA. When faced with two conflicting statutes, courts should seek to harmonize them. See *United States* v. *Estate of Romani*, 523 U.S. 517, 530-532 (1998). And where an irreconcilable conflict persists, the later-enacted statute supersedes the earlier. See *Posadas* v. *National City Bank*, 296 U.S. 497, 503 (1936). In this case,

both of those canons of construction point to the same conclusion: the Code precludes application of the FDCPA to the filing of a proof of claim for an unextinguished time-barred debt.

A. The FDCPA Should Not Be Interpreted To Conflict With The Bankruptcy Code

The court of appeals' interpretation of the FDCPA would interject an extraneous regime, enforced by a private right of action, into the administration of a bankruptcy estate—a subject that is comprehensively addressed by the Bankruptcy Code and committed to the bankruptcy courts. Such an interpretation would be an unwarranted and unprecedented intrusion into the bankruptcy process, and the FDCPA should not be read to reach so broadly.

1. Assuming, *arguendo*, that the FDCPA is ambiguous on the question whether filing a proof of claim for a time-barred debt is prohibited, but see pp. 25-38, *supra*, any ambiguity should be resolved against such an interpretation. Cf. Pet. App. 6a (characterizing the FDCPA as containing "ambiguity" on this point, but nevertheless holding that the FDCPA applies).

Where a statutory term is ambiguous, a court should "construe it to contain that permissible meaning which fits most logically and comfortably into the body of both previously and subsequently enacted law." *West Virginia University Hospitals, Inc.* v. *Casey*, 499 U.S. 83, 100 (1991). Even if it would be "plausible" *in vacuo* to read the FDCPA to bar the filing of proofs of claim for time-barred debts, there is no valid justification for adopting an interpretation that gives rise to a conflict with the Code, which specifically addresses and authorizes the filing of

this very type of document. See *American Bank & Trust Co.* v. *Dallas County*, 463 U.S. 855, 868-869 (1983).[9]

If interpreted to prohibit filing a proof of claim for an unextinguished time-barred debt, the FDCPA would patently conflict with the Code, which expressly authorizes that very practice. See pp. 15-25, *supra*. Such an interpretation would also substitute the FDCPA's broader remedies in place of the Code's own carefully calibrated ones and supplant the authority of bankruptcy courts to police conduct occurring within a bankruptcy proceeding. See, *e.g.*, 11 U.S.C. 105(a); Fed. R. Bankr. P. 9011(c)(2). The Court should instead interpret the FDCPA in a manner that harmonizes it with the Code by concluding that it does not regulate bankruptcy filings of the type at issue here.

2. This Court's decision in *Kokoszka* v. *Belford*, 417 U.S. 642 (1974), strongly supports the foregoing approach. In *Kokoszka*, the Court addressed whether the limitation on the garnishment of wages under the Consumer Credit Protection Act (CCPA) applied to certain property in a bankruptcy proceeding. See *id.* at 648-652. The Court recognized that the CCPA and the bankruptcy laws must be interpreted to "coexist." See *id.* at 650. The bankruptcy laws, the Court explained, create a "delicate

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[9] That canon applies with particular force where, as here, the ambiguous statute is the earlier-enacted one. See *FDA* v. *Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) (noting that "the meaning of one statute may be affected by other Acts, particularly where Congress has spoken subsequently and more specifically to the topic at hand"); Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 330 (2012) (explaining that "the implication of a later enactment * * * will often change the meaning that would otherwise be given to an earlier provision that is ambiguous").

balance of a debtor's protections and obligations." *Id.* at 651. In enacting the CCPA, by contrast, Congress was not concerned with "the *administration* of a bankrupt's estate," but rather with "the *prevention* of bankruptcy in the first place." *Id.* at 650. On that basis, the Court construed the CCPA garnishment provision to apply only outside bankruptcy proceedings and not within bankruptcy. See *id.* at 651-652.

So too here. Like the CCPA—the statute to which Congress subsequently added the provisions constituting the FDCPA—the FDCPA was intended to prevent bankruptcy. 15 U.S.C. 1692(a). Nothing in its text or legislative history reflects any intent to interfere with the "delicate balance" of the bankruptcy system itself, by operating directly on the administration of an estate within the framework of a bankruptcy proceeding. *Kokoszka*, 417 U.S. at 651. Accordingly, while the FDCPA, like the rest of the CCPA, governs a debt collector's conduct outside the four corners of a bankruptcy proceeding (whether before, during, or after bankruptcy), it is better understood to have no application to the debt collector's conduct within such a proceeding—at least where, as here, the Code itself specifically authorizes that conduct.

In addition, the FDCPA should not lightly be read to intrude upon the Code's operation because the Code aims to be comprehensive and uniform, whereas the FDCPA does not. As discussed above, see pp. 18-20, the Bankruptcy Code establishes an "elaborate framework" governing the claims filing and resolution process within a bankruptcy proceeding. Cf. *Elgin* v. *Department of Treasury*, 132 S. Ct. 2126, 2133 (2012) (citation omitted). Consistent with the Bankruptcy Clause of the Constitution, see U.S. Const. Art. I, § 8, cl. 4, the federal bankruptcy laws also prize uniformity and exclude conflicting state laws. See *International Shoe Co.* v. *Pinkus*, 278

U.S. 261, 265, 268 (1929); *Stellwagen* v. *Clum*, 245 U.S. 605, 613 (1918). By contrast, the FDCPA does not seek to "foreclose the States from enacting or enforcing their own laws regarding debt collection" as long as they impose stronger standards. S. Rep. No. 382, *supra*, at 6; see 15 U.S.C. 1692n. And the FDCPA is enforced primarily through a private right of action, 15 U.S.C. 1692k, which inevitably produces "wide variations" in issued decisions. *Elgin*, 132 S. Ct. at 2135 (citation omitted). A "comprehensive" scheme, like that in the Bankruptcy Code, "represents Congress' detailed judgment" and should control absent some clear indication to the contrary. *Estate of Romani*, 523 U.S. at 530-532.

Finally on this point, allowing FDCPA suits in this context would effectively create a remedy that Congress chose not to make available in the Code: namely, a private right of action for abusive or otherwise improper conduct within a bankruptcy proceeding. The Code permits a bankruptcy court to "tak[e] any action or mak[e] any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." 11 U.S.C. 105(a). Notably for present purposes, however, that provision does not permit parties in interest to bring separate suits to enforce its terms. See, *e.g.*, *In re Kalikow*, 602 F.3d 82, 97 (2d Cir. 2010); *In re Joubert*, 411 F.3d 452, 455 (3d Cir. 2005); *Walls* v. *Wells Fargo Bank, N.A.*, 276 F.3d 502, 507 (9th Cir. 2002); *Bessette* v. *Avco Financial Services, Inc.*, 230 F.3d 439, 445 (1st Cir. 2000), cert. denied, 532 U.S. 1048 (2001).

Allowing debtors to bring FDCPA suits for the filing of proofs of claim for time-barred debts would amount to authorizing a private right of action to challenge purportedly improper conduct within a bankruptcy proceeding where the Code does not provide for one—never mind that it would do so where the Code specifically condones,

rather than condemns, the conduct at issue. That would violate the "elemental canon of statutory construction" that, "where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it." *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 444 U.S. 11, 19 (1979); see *Armstrong* v. *Exceptional Child Center, Inc.*, 135 S. Ct. 1378, 1385 (2015). The Court should not open the Code to enforcement through private rights of action that would inevitably give rise to the very disuniformity the bankruptcy laws are designed to prevent.

B. If The FDCPA Is Interpreted To Conflict With The Bankruptcy Code, It Must Yield To The Later-Enacted Code

Finally, even if the Court were to conclude that the FDCPA unambiguously reached the filing of a proof of claim for a time-barred debt, it should hold that the application of the FDCPA must yield because it would create an irreconcilable conflict with the later-enacted Bankruptcy Code. See *Posadas*, 296 U.S. at 503. While "repeals by implication are not favored," *Universal Interpretive Shuttle Corp.* v. *Washington Metropolitan Area Transit Commission*, 393 U.S. 186, 193 (1968), this Court has long recognized that an implied repeal will be found where the interpretation of the earlier-enacted statute giving rise to the conflict with the later-enacted one does not appear in the "express statutory text." *United States* v. *Fausto*, 484 U.S. 439, 453 (1988).

Because the conflicting application of the FDCPA does not appear in the statutory text but has arisen only through judicial interpretation, Congress had no reason specifically to address that application when it enacted the Bankruptcy Code in 1978. See *Fausto*, 484 U.S. at 453. Indeed, it would have required an act of clairvoyance for

Congress to have anticipated this conflict between the FDCPA and the Bankruptcy Code, given that no one so much as sought to apply the FDCPA to bankruptcy proceedings until many years later. In fact, we are not aware of a single FDCPA suit challenging the filing of a proof of claim in bankruptcy in the first two decades after the Code's enactment.

The judicial interpretation of the FDCPA adopted by the Eleventh Circuit gives rise to an inescapable conflict with the Bankruptcy Code, because the Code entitles a debt collector to take an action that the interpretation would prohibit. The Bankruptcy Code provides that any "creditor"—which plainly includes a debt collector, see 11 U.S.C. 101(10)(A)—"may file a proof of claim." 11 U.S.C. 501(a). As explained above, that includes a proof of claim on an unextinguished time-barred debt. See pp. 16-18, *supra*. Thus, the Code authorizes—or, in this Court's words, "entitle[s]," *Travelers*, 549 U.S. at 449—a debt collector to file such a proof of claim. By contrast, if the FDCPA applies to the filing of such a proof of claim, it would "prohibit[]" that conduct altogether. See *Sheriff*, 136 S. Ct. at 1598; *Heintz* v. *Jenkins*, 514 U.S. 291, 292 (1995). The Code would thus entitle a debt collector to take an action that the FDCPA by judicial interpretation prohibits.

That type of conflict is so irreconcilable that it would repeal even express statutory text, much less a judicial interpretation. See *Credit Suisse Securities (USA) LLC* v. *Billing*, 551 U.S. 264, 273 (2007) (explaining that a "conflict" is "clear" where the earlier-enacted law "forbid[s] the very thing that the [later-enacted law] had then permitted"); *Branch* v. *Smith*, 538 U.S. 254, 291 (2003) (Stevens, J., concurring in part and concurring in the judgment) (noting that, "[a]s a matter of plain English, the conflict between [one statute's] prohibition [against at-large elections] and [another statute], which permitted at-

large elections, is surely irreconcilable"). As Justice Scalia colorfully put it in his treatise on statutory interpretation, "[w]hen a statute specifically permits what an earlier statute prohibited, or prohibits what it permitted, the earlier statute is (no doubt about it) implicitly repealed." Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 327 (2012). This Court has explained that implied repeal is warranted even where there is a mere "threat" that applying an earlier-enacted statute would require certain parties to avoid actions that the later-enacted statute "permits or encourages." *Credit Suisse*, 551 U.S. at 279, 282. *A fortiori*, the clear conflict created by the Eleventh Circuit's interpretation of the FDCPA suffices to warrant implied repeal here.

The Code's legislative history provides further support for that conclusion. Before the 1978 Code, Congress effectively limited the claims that could be brought into bankruptcy proceedings by imposing a provability requirement. See 11 U.S.C. 103 (1976); Bankruptcy Act of 1898, ch. 541, § 63(a), Pub. L. No. 55-541, 30 Stat. 562-563. In the 1978 Code, however, Congress sought markedly to expand the definition of a "claim" and thus the comprehensiveness of the claims process. Congress jettisoned the provability requirement in favor of the "broadest possible definition" of "claim," so as to ensure that all debts could "be dealt with in the bankruptcy case" and to "permit[] the broadest possible relief in the bankruptcy court." H.R. Rep. No. 595, *supra*, at 309. By Congress's own recognition, that represented a "significant departure" from then-existing law. *Ibid.* It would be inconsistent with Congress's objective to construe an earlier-enacted, non-bankruptcy statute to limit the proofs of claim that can be filed in a bankruptcy proceeding.

* * * * *

The straightest path to a reversal of the judgment below is simply to hold that the FDCPA does not reach the filing of a proof of claim for an unextinguished time-barred debt. But if the FDCPA were read to have that reach, applying the FDCPA to the filing of such a proof of claim would create an impermissible conflict with the later-enacted Bankruptcy Code. In either event, the Eleventh Circuit's application of the FDCPA to a proof of claim for an unextinguished time-barred debt is improper. This Court should therefore reverse the Eleventh Circuit's outlying judgment.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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NOVEMBER 2016

APPENDIX

11 U.S.C. 101 provides in relevant part:

In this title the following definitions shall apply:

* * *

(5) The term "claim" means—

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; * * * .

* * *

(10) The term "creditor" means—

(A) entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor; * * * .

* * *

(12) The term "debt" means liability on a claim.

11 U.S.C. 501 provides in relevant part:

(a) A creditor or an indenture trustee may file a proof of claim. An equity security holder may file a proof of interest. * * *

11 U.S.C. 502 provides in relevant part:

(a) A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects.

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

(1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured; * * * .

11 U.S.C. 558 provides in relevant part:

The estate shall have the benefit of any defense available to the debtor as against any entity other than the estate, including statutes of limitation, statutes of frauds, usury, and other personal defenses. A waiver of any such defense by the debtor after the commencement of the case does not bind the estate.

11 U.S.C. 704 provides in relevant part:

(a) The trustee shall—

* * *

(5) if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper * * * .

11 U.S.C. 1302 provides in relevant part:

* * *

(b) The trustee shall—

(1) perform the duties specified in sections 704(a)(2), 704(a)(3), 704(a)(4), 704(a)(5), 704(a)(6), 704(a)(7), and 704(a)(9) of this title * * * .

15 U.S.C. 1692 provides:

(a) Abusive practices

There is abundant evidence of the use of abusive, deceptive, and unfair debt collection practices by many debt collectors. Abusive debt collection practices contribute to the number of personal bankruptcies, to marital instability, to the loss of jobs, and to invasions of individual privacy.

(b) Inadequacy of laws

Existing laws and procedures for redressing these injuries are inadequate to protect consumers.

(c) Available non-abusive collection methods

Means other than misrepresentation or other abusive debt collection practices are available for the effective collection of debts.

(d) Interstate commerce

Abusive debt collection practices are carried on to a substantial extent in interstate commerce and through means and instrumentalities of such commerce. Even where abusive debt collection practices are purely intrastate in character, they nevertheless directly affect interstate commerce.

(e) Purposes

It is the purpose of this subchapter to eliminate abusive debt collection practices by debt collectors, to insure that those debt collectors who refrain from using abusive

debt collection practices are not competitively disadvantaged, and to promote consistent State action to protect consumers against debt collection abuses.

15 U.S.C. 1692e provides in relevant part:

A debt collector may not use any false, deceptive, or misleading representation or means in connection with the collection of any debt. Without limiting the general application of the foregoing, the following conduct is a violation of this section:

* * *

(2) The false representation of—

(A) the character, amount, or legal status of any debt; or

(B) any services rendered or compensation which may be lawfully received by any debt collector for the collection of a debt.

* * *

(10) The use of any false representation or deceptive means to collect or attempt to collect any debt or to obtain information concerning a consumer. * * *

15 U.S.C. 1692f provides in relevant part:

A debt collector may not use unfair or unconscionable means to collect or attempt to collect any debt. Without limiting the general application of the foregoing, the following conduct is a violation of this section:

(1) The collection of any amount (including any interest, fee, charge, or expense incidental to the principal obligation) unless such amount is expressly authorized by

the agreement creating the debt or permitted by law. * * *

Federal Rule of Bankruptcy Procedure 3001 provides in relevant part:

(a) Form and content

A proof of claim is a written statement setting forth a creditor's claim. A proof of claim shall conform substantially to the appropriate Official Form.

* * *

(c) Supporting information

* * *

(3) Claim based on an open-end or revolving consumer credit agreement

(A) When a claim is based on an open-end or revolving consumer credit agreement—except one for which a security interest is claimed in the debtor's real property—a statement shall be filed with the proof of claim, including all of the following information that applies to the account:

(i) the name of the entity from whom the creditor purchased the account;

(ii) the name of the entity to whom the debt was owed at the time of an account holder's last transaction on the account;

(iii) the date of an account holder's last transaction;

(iv) the date of the last payment on the account; and

(v) the date on which the account was charged to profit and loss.

(B) On written request by a party in interest, the holder of a claim based on an open-end or revolving consumer credit agreement shall, within 30 days after the request is sent, provide the requesting party a copy of the writing specified in paragraph (1) of this subdivision. * * *

Federal Rule of Bankruptcy Procedure 9011 provides in relevant part:

* * *

(b) Representations to the court

By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,

(1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;

(2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;

(3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and

(4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

(c) Sanctions

If, after notice and a reasonable opportunity to respond, the court determines that subdivision (b) has been violated, the court may, subject to the conditions stated below, impose an appropriate sanction upon the attorneys, law firms, or parties that have violated subdivision (b) or are responsible for the violation. * * *

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No. 16-348

In the Supreme Court of the United States

MIDLAND FUNDING, LLC, PETITIONER

v.

ALEIDA JOHNSON

*ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT*

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In the Supreme Court of the United States

No. 16-348

MIDLAND FUNDING, LLC, PETITIONER

v.

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ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

INTRODUCTION

The Fair Debt Collection Practices Act (FDCPA) regulates a narrow class of actors who face adverse incentives: professional consumer-debt collectors. To protect innocent consumers, the FDCPA prohibits "deceptive" or "unfair" practices in connection with the collection of a debt. For example, lower courts have widely held that filing suit to recover on a time-barred debt violates the Act. The reason is obvious: such lawsuits seek to unfairly frighten or deceive consumers into paying a stale debt where they have no legal obligation to do so.

Petitioner in this case is a professional consumer debt collector. Its tactics here are more sophisticated, but equally cynical. Petitioner uses the bankruptcy claim process—where claims are cheap to file and presumptively valid—as a means to collect on knowingly time-

barred debts, fully aware that the relevant stakeholders (debtors, their counsel, and bankruptcy trustees) will often fail to object. Indeed, that is the only reason that petitioner's business makes money: because it is *certain* that some time-barred debts will slip through. Petitioner effectively admits that if the bankruptcy system functioned as Congress intended, these claims would be rejected 100 percent of the time.

Petitioner's brief is perhaps most telling for what it does not say. It does not contest that petitioner and its peers file claims in the hope of collecting unenforceable debts. It does not argue that they have any good-faith basis for these filings or any legitimate response once anyone objects. In fact, petitioner does not discuss the troubling industry practice at issue here at all.

Instead, petitioner argues that the Bankruptcy Code (and its underlying policies) somehow immunizes its behavior. Petitioner's arguments, however, misapprehend the law and are predicated on clear misrepresentations about the realities of the consumer-bankruptcy system.

Petitioner wrongly suggests, for example, that consumers are not hurt by its illegitimate claims; only other creditors are. Not so. For example: most Chapter 13 plans fail, leaving the debtor obligated to pay her debts in full. Monies wasted on time-barred debts wrongly included in the failed Chapter 13 plan leaves the debtor with a higher outstanding obligation to her real, surviving creditors than if her resources had not been siphoned away by illegitimate debt. And money paid on stale debts reduces the amount the debtor has to satisfy legitimate non-dischargeable debts, like child support or student loans. Of course, illegitimate claims also harm everyone by increasing the costs of our bankruptcy system.

Nor, as petitioner remarkably suggests, does presentment of a time-barred debt somehow affirmatively *benefit* the debtor by promoting a "fresh start." Those debts are already a practical nullity, and in any event scheduling these claims would not have the benefit that petitioner alleges.

Finally, the trustee's presence does not exculpate petitioner or legitimize its conduct. Trustees neither have infinite time nor offer it free of charge, which means—as petitioner well knows—that the estate and its trustee face a limited economic incentive to carefully scrutinize smaller claims. It is deceptive and unfair for petitioner to exploit *en masse* that systemic reality in an effort to collect on expired debts—which is exactly why the U.S. Trustee has sued Resurgent Capital Services, L.P.—the defendant in the companion case before the Eleventh Circuit below and an *amicus* supporting petitioner in this Court.

STATEMENT

This case presents fundamental questions concerning the interaction of the FDCPA and the Bankruptcy Code. As such, respondent begins with a brief examination of those two statutory regimes followed by a brief discussion of the relevant factual and procedural history of this case.

A. Statutory Background

1. Congress enacted the FDCPA in 1977 to "eliminate abusive debt collection practices by debt collectors, to insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged, and to promote consistent State action to protect consumers against debt collection abuses." 15 U.S.C. 1692(e). It recognized both the egregious conduct of "a small segment" of independent debt collectors and

the blamelessness of their targets—"the number of persons who willfully refuse to pay *just* debts is miniscule." S. Rep. No. 95-382, at 3 (1977) (emphasis added).

The Act accordingly regulates a narrow class of actors: professional consumer debt collectors.[1] Congress recognized that unlike original creditors, these third-party debt collectors would not feel "restrained by the desire to protect their good will" or "[]concerned with the consumer's opinion of them." S. Rep. No. 95-382, at 2. They have the "incentive to collect by any means." *Ibid.*

In regulating that narrow class of actors, the FDCPA imposes broad prohibitions. See *Jerman* v. *Carlisle, McNellie, Rini, Kramer & Ulrich LPA*, 559 U.S. 573, 587 (2010). It provides that "[a] debt collector may not use any false, deceptive, or misleading representation or means in connection with the collection of any debt." 15 U.S.C. 1692e. It separately forbids the use of "unfair or unconscionable means to collect or attempt to collect any debt." 15 U.S.C. 1692f. In both sections, the Act contains non-exhaustive lists of abusive collection practices. See S. Rep. No. 95-382, at 4 ("This will enable courts, where appropriate, to proscribe other improper conduct which is not specifically addressed."). And the enumerated practices themselves reflect the expanse of prohibited

[1] The Act defines "debt collector" as any person whose business has the "principal purpose" of debt collection or who "regularly" collects debts "due another." 15 U.S.C. 1692a(6); see, *e.g.*, S. Rep. No. 95-382, at 3 ("The primary persons intended to be covered are independent debt collectors."). The Act defines "debt" to mean a primarily "personal, family or household" obligation of a "consumer," and in turn defines "consumer" as a "natural person." 15 U.S.C. 1692a(3), (5); see, *e.g.*, S. Rep. No. 95-382, at 3 ("This bill applies only to debts contracted by consumers for personal, family, or household purposes; it has no application to the collection of commercial accounts.").

conduct, outlawing not only aggressive, intimidating tactics but also more subtle efforts to deceive the debtor.[2]

Congress included a private right of action and statutory damages to incentivize private policing.[3] However, Congress sharply limited the damages recoverable in class actions to prevent over-enforcement.[4] Importantly, Congress also provided an affirmative defense to debt collectors who implement "procedures reasonably adapted to avoid" violations of the Act. 15 U.S.C. 1692k(c).

2. Once a debtor files for bankruptcy, a bankruptcy estate is created that consists of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. 541(a)(1). Creditors who wish to recover from the estate "may file a proof of claim," 11 U.S.C. 501(a), which is "a written statement setting forth a creditor's claim." Fed. R. Bankr. P. 3001. The Code defines a "claim" as a "right to payment, whether or not such right is * * * fixed, contingent, matured, unmatured, disputed, [or] undisputed." 11 U.S.C. 101(5)(A).

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[2] For example, those efforts include falsely representing the "character, amount, or legal status of the debt"; using "deceptive means to collect or attempt to collect any debt"; and collecting an amount that is not "expressly authorized by the agreement creating the debt or permitted by law." 15 U.S.C. 1692e(2), (10), 1692f(1).

[3] In an individual action, a consumer may recover actual damages plus statutory damages up to one thousand dollars. 15 U.S.C. 1692k(a)(1), (2)(A). A successful plaintiff may recover costs and attorneys' fees. 15 U.S.C. 1692k(a)(3).

[4] In a class action, statutory damages for the class members other than the named plaintiffs may not exceed the lesser of $500,000 or 1% of the debt collector's net worth. 15 U.S.C. 1692k(a)(2)(B). A successful class plaintiff may also recover costs and attorneys' fees. 15 U.S.C. 1692k(a)(3).

Filing a proof of claim is easy and free. Creditors file claims on a simple, standardized 3-page form. See Fed. R. Bankr. P. 3001(a)-(b) & 3002(c). No filing fee or attorney is required.[5] For most consumer credit agreements, creditors need not even attach any underlying documentation when they submit their claim. See Fed. R. Bankr. P. 3001(c)(3)(A). A copy of the agreement—which would include any choice-of-law provision—must be provided only on written request. See *id.* 3001(c)(3)(B).

Unlike filing claims, *objecting to* claims is time-consuming and costly.[6] The objector must make a written objection, notice a hearing, and serve multiple parties. Fed. R. Bankr. P. 3007(a); see *id.* 9014. The objector then must attend the hearing and overcome the claim's prima facie validity. Finally, a formal order disallowing the claim must be prepared and served. *Id.* 9022(a).

Debtors regularly fail to object to patently time-barred claims. This is true for various reasons. For example, some debtors are *pro se.*[7] And many others are represented by counsel who are paid a flat fee for services that often do not include examining proofs of claim or filing objections.

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[5] PACER even provides "large claims filers" the ability to file claims electronically in "batches." See *Description of the Process for Electronic Filing of Bankruptcy Claims Information in CM/ECF by Creditors* (April 16, 2013).

[6] A proof of claim is subject to objection by any "party in interest" (the debtor, another creditor, or the bankruptcy trustee). 11 U.S.C. 502(a).

[7] See, *e.g.*, *Owens* v. *LVNV Funding, LLC*, 832 F.3d 726, 740 (7th Cir. 2016) (Wood, J., dissenting) (noting that 9% of bankruptcy filings in the Northern District of Illinois were *pro se*); U.S. Bankr. Court for the Cent. Dist. Cal., *Annual Report* 17 (2015) (noting that 37.5% of Chapter 13 petitions were *pro se*).

Trustees in consumer bankruptcy cases also regularly fail to object to patently time-barred claims. It is important to understand why: Bankruptcy trustees are statutorily obligated to "examine proofs of claims," but they must object to improper claims only "if a purpose would be served." 11 U.S.C. 704(a)(5); 11 U.S.C. 1302(b)(1) (imposing the same duty on Chapter 13 trustees). Even when the facts included on a proof of claim would indicate that the underlying debt is patently time-barred, it is often economically imprudent for a trustee to spend time examining and objecting to such a claim. Objecting to improper, low dollar-value claims is often counterproductive because the trustee's expenses get passed on to other parties.[8] These expenses are paid before most unsecured claims in a Chapter 7 bankruptcy (11 U.S.C. 726(a)(1)-(2)), and are entitled to "full payment" by the debtor in a Chapter 13 case (11 U.S.C. 1322(a)(2). An objection thus shrinks the pool of resources available to satisfy meritorious debts or, in a Chapter 13 case, may make plan confirmation less likely if the cost exceeds the savings from disallowing the claim.

The failure of debtors and trustees to object to patently time-barred debt results in the allowance of claims that are, in fact, unenforceable. That is true because the filing of a proof of claim is "prima facie" evidence of its

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[8] The Code allows the trustee's counsel compensation and reimbursement for her services and expenses. See 11 U.S.C. 327(a) (providing that the trustee may retain counsel), 330(a)(1) (providing for "reasonable compensation for actual, necessary services" and "reimbursement for actual, necessary expenses"); 503(b)(2) (permitting an administrative expense for "compensation and reimbursement" under Section 330(a)), 507(a)(2) (establishing priority for administrative expenses).

validity. Fed. R. Bankr. P. 3001(f). As such, any claim is automatically "allowed" unless a party in interest objects and satisfies her burden to show that "such claim is unenforceable against the debtor * * * under any agreement or applicable law." 11 U.S.C. 502(a), (b)(1). And Congress specifically included "statutes of limitation" as one means of proving unenforceability. 11 U.S.C. 558.

Allowing improper claims in bankruptcy proceedings has an obvious, significant, and negative economic impact on innocent creditors. The precise mechanism of that effect depends on whether Chapter 7 or Chapter 13 governs. A Chapter 7 bankruptcy entails the liquidation of the debtor's (non-exempt) property, where the proceeds go first to priority creditors with the surplus distributed to allowed, unsecured claims on a pro rata basis. See 11 U.S.C. 726(a)(1)-(2). Every allowed claim thus decreases the amount of funds available to pay down other claims. A Chapter 13 bankruptcy provides a debtor who has regular income a discharge of debts by using her income to satisfy claims; she must either pay all unsecured claims in full or use her disposable income to make pro rata payments to those claimholders over several years. See 11 U.S.C. 1325(b). In either situation, every allowed claim decreases the amount of funds available to satisfy other claims.

Contrary to the factual assertions of petitioners, allowing improper claims in bankruptcy also has significant and negative consequences for innocent debtors. Two such situations are notable:

First, most Chapter 13 debtors (like respondent) default under their payment plans. Except under narrow circumstances, these debtors do not obtain a discharge of *any* debts. See 11 U.S.C. 1328(a)-(b). The pro rata distribution of payments to creditors thus matters deeply—an allowed illegitimate claim siphons a dollar from a legiti-

mate claim. When the plan fails, the debtor is stuck with larger legitimate debts than had the (illegitimate) claim been properly disallowed.

Second, some important debts (like student loans and domestic support obligations) are generally not dischargeable in bankruptcy (either Chapter 7 or Chapter 13). See 11 U.S.C. 523(a), 1328(a)(2). Again, every dollar allocated to an improperly allowed claim (like a time-barred obligation) cannot pay down a legitimate, nondischargeable debt. Accordingly, regardless of the plan's success, allowing an indisputably time-barred claim leaves the debtor with larger debts than she should have.[9]

B. Factual Background

1. Debt buyers like petitioner represent "[t]he most significant change in the debt collection business in recent years." Fed. Trade Comm'n, *Collecting Consumer Debts: The Challenges of Change* 13 (Federal Trade Commission 2010) (FTC 2010 Report).[10] Although hundreds of entities operate in this area, the industry remains substantially concentrated, with just nine firms—including petitioner's parent company Encore Capital Group ("Encore")—responsible for over 76% of all debt purchases in 2008. Fed. Trade Comm'n, *The Structures*

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[9] Further, in limited circumstances in both Chapter 7 and Chapter 13 bankruptcies, surplus may remain for the debtor. See 11 U.S.C. 726(a)6); 11 U.S.C. 1325(b)(1)(A). In those scenarios, improperly allowed claims reduce that surplus.

[10] Industry revenues have exploded: Between 2003 and 2012, petitioner's parent company realized a 373% increase, while another major player saw nearly 600% growth. Lisa Stifler & Leslie Parrish, *The State of Lending in America & its Impact on U.S. Households: Debt Collection & Debt Buying* 6 (Center for Responsible Lending 2014).

and Practices of the Debt Buying Industry 7, 13 (2013) (FTC 2013 Report).[11]

Debt buyers purchase charged-off debt from creditors "for pennies-on-the-dollar." Stifler & Parish at 2. Credit-card debt is most common,[12] but professional buyers also acquire student loans, medical debt, utility and phone bills, tax liens, car loans, and mortgage and auto deficiencies. *Id.* at 3. Debts "are typically bundled into portfolios" to be sold. FTC 2013 Report at 17.

2. Mass consumer debt buyers like Midland and Resurgent price bundles of consumer debt based in part on their age and timeliness. *See* FTC 2013 Report at 21.[13] As a debt ages, its value drops precipitously: Whereas a debt less than 3 years old generally costs 7.9 cents per dollar of debt, a 3 to 6 year-old debt costs only 3.1 cents and a 6 to 15 year old debt 2.2 cents; debts older than 15 years cost "effectively nothing." *Id.* at 23-24.[14] As their

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[11] These nine firms include Sherman Financial Group, LLC, which owns Resurgent Capital Services, L.P., ("Resurgent") a defendant in this case before the Eleventh Circuit and an *amicus curiae* before this Court, and LVNV Funding, LLC, a defendant in the Seventh Circuit decision presenting the identical issues raised here. See *Owens* v. *LVNV Funding, LLC*, 832 F.3d 726 (7th Cir. 2016).

[12] Federal regulations require banks to "charge off" credit-card debts after a certain amount of time. See FTC 2013 Report at 13 & n.58.

[13] Debt buyers examine a variety of factors including "the average balance per debt in the portfolio, the average number of months since the creditor charged off the debt, the average number of months since the debtor made the last payment, the states in which the debtors reside, the distribution of balances on the debts, the prevalence of time-barred debts, and the type of accounts being sold." FTC 2013 Report at 21.

[14] "Debt buyers presumably pay less for older debts because their expected return from collecting on those debts is lower, likely reflecting the fact that the consumers may be less willing or able to

pennies-on-the-dollar prices reflect, these debts are extremely difficult to collect.[15]

The ability to accurately price these debts based on age and timeliness is critical to a debt buyer's success.[16] For example, Encore touts its "information advantage" and proprietary valuation models as two keys to its competitive advantage. Encore 10-K 3. To that end, Encore claims to "obtain detailed information regarding the portfolio's accounts," and it "continually monitor[s] applicable changes to laws governing statutes of limitations." *Id.* at 5, 7. Encore is not unique—the FTC concluded "that debt buyers usually are likely to know or be able to determine whether the debts on which they are collecting are beyond the statute of limitations." FTC 2013 Report at 49; see also *id.* at 49 & n.204.

3. Over the years, mass consumer debt buyers like Midland and Resurgent have used a variety of aggressive tactics, including to recover debt that *they know* is time-barred.[17] Courts and regulators have thwarted these different efforts time and again.

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pay the debt or the consumers may be more difficult for debt buyers to locate." *Id.* at 24. Moreover, "[m]ost states' statutes of limitations are between three and six years, and no state's statute of limitations is longer than fifteen years." *Id.* at 42.

[15] Encore, for example, "generate[s] payments from less than one percent of our accounts every month." *Id.* at 2.

[16] The low barriers to entry in the industry pressure even the big nine firms to adapt. See, *e.g.*, Encore Capital Group, Inc., 2016 Form 10-K 16 ["Encore 10-K"].

[17] In fact, the rise of the debt-buying industry has corresponded with "a significant rise in" consumer complaints about collection practices. FTC 2013 Report at 1. In 2013 alone, for example, the FTC received over 200,000 such complaints. Stifler & Parish at 2.

For example, debt buyers have increasingly used litigation as a debt collection strategy in recent years. See, *e.g.*, Jessica Silver-Greenberg, *Boom in Debt Buying Fuels Another Boom—in Lawsuits*, Wall Street Journal (Nov. 28, 2010) ("The big explosions in lawsuit is coming not from lenders but from firms who buy debt.").[18] Encore filed 245,000 suits in one year, and petitioner alone filed 110 lawsuits on one day in a single state court (Bronx County Civil Court). *Boom in Debt Buying*, *supra*; see also Fox, *supra*, at 373-374 (petitioner filed 1,875 lawsuits in 3 months in Indiana).

Debt buyers generally "rely on overburdened 'small claims courts,' where the state court formal rules of evidence typically do not apply." Peter A. Holland, *The One Hundred Billion Dollar Problem in Small Claims Court: Robo-Signing and Lack of Proof in Debt Buyer Cases*, 6 J. Bus. & Tech. L. 259, 261 (2011) ("Debt buyers shy away from large-value cases, which would require formal proof that complies with the forum state's rules of evidence.").[19] They often prevail on even meritless claims because debtors default. FTC 2013 Report 45 ("90% or

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[18] See also Stifler & Parish at 9; see, *e.g.*, FTC 2009 Report at 55 ("The vast number of debt collection suits filed in recent years has posed considerable challenges to the smooth and efficient operation of courts."); CFPB Order at 13 ("Encore has filed hundreds of thousands of lawsuits to collect Consumer Debt.").

[19] See also, *e.g.*, Nat'l Consumer Law Ctr., Comment to the Federal Trade Commission Regarding the Fair Debt Collection Practices Act 3 (Aug. 1, 2009) (explaining that small-claims courts are especially attractive "because of their relaxed procedural formalities, low evidentiary standards, inexpensive filing fees, and negligible pleading requirements"). Sometimes, however, courts' local rules incentivize buyers to sue instead in general-jurisdiction courts. See Judith Fox, *Do We Have a Debt Collection Crisis? Some Cautionary Tales of Debt Collection in Indiana*, 24 Loy. Consumer L. Rev. 355 (2012).

more of consumers sued in these actions do not appear in court to defend"); Holland, *supra*, at 263 (debt buyers have won "billions of dollars in default judgments").[20]

But courts have imposed considerable obstacles to using litigation to collect debt. Lower courts have consistently held that filing suit to collect on a knowingly time-barred debt violates the FDCPA. See, *e.g.*, *Crawford* v. *LVNV Funding, LLC*, 758 F.3d 1254, (11th Cir. 2014) ("Federal circuit and district courts have uniformly held that a debt collector's threatening to sue on a time-barred debt and/or filing a time-barred suit in state court to recover that debt violates §§ 1692e and 1692f.").[21]

Regulators have also intervened. For example, the Consumer Financial Protection Bureau (CFPB) found that "Encore sent thousands of letters containing time-limited 'settlement' offers that failed to disclose that the Debt it was collecting was too old for litigation and that implied a legally enforceable obligation to pay the Debt." Consent Order at 18, *In re Encore Capital Group, Inc.*, No. 2015-CFPB-0022 (Sept. 9, 2015) (CFPB Order).[22]

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[20] Despite the lack of documentation supporting the debt, buyers have been able to take advantage "of lax—and often unenforced—procedural rules." Holland, *supra*, at 262-263.

[21] Some courts have also imposed filing restraints—one Indianapolis judge limited a law firm used by Encore to filing 500 new debt-collection cases every two weeks. *Boom in Debt Buying*, *supra*.

[22] In 2015 Petitioner and its other Encore affiliates stipulated to a consent order from the CFPB to settle accusations of unfair and predatory debt collection practices. Each month, petitioner and its affiliates received approximately 30,000 written disputes, 10,000 oral disputes, and 100,000 electronic disputes from consumers regarding their collection practices. *Id.* at 10. Based on a host of violations of the FDCPA and other consumer-protection laws—including attempting to collect on time-barred debt—the CFPB ordered restitution of at least $34 million. *Id.* at 45-47. The CFPB also ordered peti-

And another Encore entity made thousands of harassing and abusive phone calls to attempt debt collection. *Ibid.* The CFPB concluded that petitioner and its affiliates violated the FDCPA by "represent[ing], directly or indirectly, expressly or by implication, that [c]onsumers had a legally enforceable obligation to pay" time-barred debt. *Id.* at 28.[23]

4. With some avenues cut off, bankruptcy is the new frontier for mass consumer debt buyers like Midland and Resurgent seeking to knowingly collect time-barred debt.[24] Indeed, courts have noted the flood of knowingly time-barred claims.[25]

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tioner and its affiliates to cease "[c]ollecting or attempting to collect any [t]ime-[b]arred [d]ebt through any means, including but not limited to telephone calls and written communications, without clearly and prominently disclosing to the [c]onsumer" that the debt was time-barred and could not be enforced. *Id.* at 38-39.

[23] The CFPB also found that, "[i]n numerous instances, Encore has threatened and filed suit on Debt that was past the applicable statutes of limitations." CFPB Order at 17.

[24] In 2015, Encore filed nearly $314 million worth of claims, at an average claim value of $3,391.30, although it is unclear what proportion pertained to time-barred debt. See Am. InfoSource, *AIS Insight 2015 Year in Review* 14.

[25] See, *e.g.*, *Crawford*, 758 F.3d at 1256 ("A deluge has swept through U.S. bankruptcy courts of late. Consumer debt buyers—armed with hundreds of delinquent accounts purchased from creditors—are filing proofs of claim on debts deemed unenforceable under state statutes of limitations."); *In re Jenkins*, 456 B.R. 236, 239 n.2 (Bankr. E.D.N.C. 2011) (describing "[t]he plague of stale claims emanating from debt buyers"); *In re Andrews*, 394 B.R. 384, 387 (Bankr. E.D.N.C. 2008) ("The phenomena of bulk debt purchasing has proliferated and the uncontrolled practice of filing claims with minimal or no review is a new development that presents a challenge for the bankruptcy system.").

Recently, the United States Trustee sued Resurgent for "knowingly and strategically fil[ing] thousands of" claims "for debt that is time-barred and subject to disallowance upon objection as a matter of law pursuant to 11 U.S.C. § 502(b)(1)." Compl. ¶ 35, *In re Freeman-Clay* v. *Resurgent Capital Servs., L.P.*, No. 14-41871-DRD13 (Bankr. W.D. Mo. Aug. 22, 2016).

The U.S. Trustee alleged that Resurgent deliberately refrained from bringing suit on these claims outside bankruptcy because it knew they were stale. See *id.* ¶ 40 ("the only way Resurgent attempts to monetize this stale debt using any legal process is by asserting these otherwise legally unenforceable claims in bankruptcy cases throughout the country"). And like Resurgent, petitioner promises to "not pursue collections through legal means" on any account "past its applicable statute of limitations." Encore 10-K at 7.

C. Procedural History

Petitioner purchased $1,879.71 of consumer debt incurred by respondent. See J.A. 18, 25. The last transaction on the consumer credit account was in May 2003, and the debt was charged off as of January 2004. J.A. 18. Alabama's six-year statute of limitations for the collection of that debt thus lapsed in May of 2009. See Ala. Code § 6-2- 34. In fact, virtually every state's statute of limitations would have expired by this time. See FTC 2013 Report at 42 & nn.175-176.

In 2014, five years after the statute of limitations lapsed and over a decade after the last transaction on the account, respondent filed for personal bankruptcy under Chapter 13 of the Bankruptcy Code. J.A. 25. Even though the statute of limitations for the collection of the debt had long since expired, petitioner filed a claim in the bankruptcy proceeding for the debt it had purchased. See J.A. 12-19. Respondent objected to the claim on the

ground it lacked proper documentation. J.A. 21. Petitioner did not attempt to remedy that defect, and the bankruptcy court disallowed the claim. The court then approved a repayment plan for the allowed claims.[26]

1. Respondent's counsel immediately filed a class action against Midland under the FDCPA, hoping to end a scheme that injures vulnerable debtors with increasing frequency. What Midland derides as a "form complaint" filed "three days after the bankruptcy court disallowed petitioner's claim," Pet. Br. 8, was—in fact—a measured challenge to petitioner's notorious and illegal business model (in direct response to the paradigmatic, frivolous proof of claim filed in respondent's bankruptcy).

In this lawsuit, Respondent alleges that petitioner's attempt to collect a knowingly time-barred debt was "un-

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[26] Petitioner complains that "the record does not reflect whether there was some reason the limitations defense would not apply." Br. 8 n.1. That is grossly misleading. As petitioner is undoubtedly aware, the record also does not reflect that petitioner made any effort whatsoever to show that the claim was meritorious, such as amending the claim or supplying documentation supporting the claim's legitimacy. See, *e.g.*, *In re Taylor*, 363 B.R. 303, 310 (Bankr. M.D. Fla. 2007) ("Certainly, if a creditor fails to initially attach sufficient documentation, the creditor should be given an opportunity to supplement the initial claim to add the additional supporting documentation. *See In re South Atlantic Financial Corp.*, 767 F.2d 814, 819 (11th Cir.1985) ('[I]n a bankruptcy case, amendment to a claim is freely allowed where the purpose is to cure a defect in the claim as originally filed, to describe the claim with greater particularity or to plead a new theory of recovery on the facts set forth in the original claim.')"). What's more, "the majority view [is] that a proof of claim may not be disallowed where the sole basis of objection is the creditor's failure to attach sufficient documentation." *In re Brunson*, 486 B.R. 759, 773 (Bankr. N.D. Tex. 2013). To be clear: instead of pursuing its claim or contesting the objection, petitioner gave up. The explanation for this surrender is obvious: the claim was frivolous.

fair," "unconscionable," "deceptive," and "misleading" in violation of 15 U.S.C. 1692e and 1692f. The district court rejected petitioner's argument that respondent failed to state a claim under the FDCPA. Pet. App. 19a-20a. The court nonetheless granted petitioner's motion to dismiss on the ground that the Bankruptcy Code precluded the FDCPA suit because the Code granted petitioner a "right" to file the time-barred claim. Pet. App. 20a-37a.

2. The court of appeals reversed. Pet. App. 1a-15a. The court first reaffirmed its prior holding from *Crawford* that "a debt collector violates the FDCPA when it files a proof of claim in a bankruptcy case on a debt that it knows to be time-barred." Pet. App. 2a, 5a. *Crawford* had explained that the reasons for "outlaw[ing] 'stale suits to collect consumer debts'" apply equally "in the bankruptcy context." 758 F.3d at 1259-1260. As in ordinary litigation, time-barred claims take unfair advantage of debtors, deliberately "creat[ing] the misleading impression" that stale debts can be enforced. *Id.* at 1261. And bankruptcy debtors will often give up rather than fight a frivolous claim: "filing objections to time-barred claims consumes energy and resources in a debtor's bankruptcy case, just as filing a limitations defense does in state court." *Ibid.* As the court reasoned, "the limitations period provides a bright line for debt collectors and consumer debtors, signifying a time when the debtor's right to be free of stale claims comes to prevail over a creditor's right to legally enforce the debt." *Id.* at 1260-1261. Accordingly, *Crawford* concluded, "[j]ust as LVNV would have violated the FDCPA by filing a lawsuit on

stale claims in state court, LVNV violated the FDCPA by filing a stale claim in bankruptcy court." *Id.* at 1262.[27]

The court below then addressed the question that *Crawford* held open: whether the Bankruptcy Code "preclude[s] an FDCPA claim in the context of a Chapter 13 bankruptcy when a debt collector files a proof of claim it knows to be time-barred." Pet. App. 7a. The court held that the Code "does not preclude an FDCPA claim in the bankruptcy context." Pet. App. 15a. Although it agreed with the district court that the Code does not itself prohibit the knowing filing of a time-barred claim, the court explained that the Act, which applies only to "debt collectors," "addresses the later ramifications of filing [such] a claim." *Id.* at 12a. By filing a time-barred claim, which the court recognized was an "unfair" and "deceptive" debt collection practice under the Act, a debt collector "is simply opening [itself] up to a potential lawsuit for an FDCPA violation." *Id.* at 14a (internal quotation marks omitted). Because the Act prohibits certain predatory conduct by debt collectors even if that conduct is not separately prohibited by the Code, the court explained that "the Code does not . . . protect those creditors from all liability." *Id.* at 2a. Accordingly, the court held, the two statutory schemes can be "reconciled." *Id.* at 12a.

3. The court of appeals denied rehearing en banc without a vote. Pet. App. 16a-17a.

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[27] Other courts have since held that this conduct does not violate the FDCPA, two of them over vigorous dissents. See *Owens* v. LVNV Funding, LLC (7th Cir. 2016) (Wood, C.J., dissenting); *In re Dubois*, 834 F.3d 522 (4th Cir. 2016) (Diaz, J., dissenting).

SUMMARY OF ARGUMENT

Contrary to Midland's contention, the FDCPA prohibits filing proofs of claim on knowingly time-barred debt.

I. Midland's clear abuse of the bankruptcy process violates the FDCPA. Midland represents that its time-barred claims are valid and enforceable when it knows the opposite is true. This deceives debtors and creates obvious risks of illegitimate claims slipping through the process unnoticed.

Midland also exploits the claims-allowance process to collect when the system *malfunctions*. Midland engages in a systemic effort to "flood" bankruptcy proceedings with thousands of time-barred claims. Midland files these claims without any legitimate basis or useful purpose. There is *no* scenario in which these claims survive under proper review: Midland's claims are invalid and will be universally rejected if the process functions as Congress intended. Midland's entire scheme is premised on the hope that the system will break down and fail—as it predictably does when debtors fail to object and trustees fail to weed out invalid claims. This flagrant abuse imposes needless costs on courts and innocent parties; it is exactly the kind of false, deceptive, and unfair practice that the FDCPA was designed to avoid.

As the Eleventh Circuit held in *Crawford*, the same acts that violate the FDCPA outside bankruptcy also violate the FDCPA within it. Courts routinely hold that debt collectors violate the FDCPA by filing state-court litigation over time-barred debts. See, *e.g.*, *Phillips* v. *Asset Acceptance, LLC*, 736 F.3d 1076, 1079 (7th Cir. 2013). The same rationale applies in this context: there is no reason that debt collectors suddenly have more freedom to pursue stale claims once debtors enter bankruptcy. Ironically, had Johnson not declared bankruptcy,

Midland indisputably would have no right to demand payment from anyone. Bankruptcy promises a fresh start by forgiving debt. Midland's attempt to use bankruptcy to *add* debt flips the system on its head.

II. Midland says that its behavior is justified by the Code, but Midland is incorrect. The Code, unremarkably, does not tolerate claims that should always lose unless something goes wrong. Midland has no good-faith basis for pursing indisputably time-barred claims, and its contrary position is at odds with the Code's text, structure, and purpose. There is no "right" to file knowingly time-barred claims.

III. Midland is also incorrect that the Bankruptcy Code repealed the FDCPA *by implication*. Such repeals must be established through "clear text" or "irreconcilable conflict" (*J.E.M. Ag Supply, Inc.* v. *Pioneer Hi-Bred Int'l, Inc.*, 534 U.S. 124, 143-144 (2001); *Morton* v. *Mancari*, 417 U.S. 535, 550 (1974)), and Midland fails that heavy burden.

A. Midland concede that there is no *textual* preclusion. Put simply, nothing in the Code or the FDCPA possibly qualifies as a "clear statement" that one scheme precludes the other.

B. 1. Nor is there any irreconcilable conflict. As explained above, the FDCPA prohibits what the Code does not even allow, and its application would not undermine the Code, but *promote* it. Because nothing compels (or even permits) an act under one scheme that violates the other, there is no conceivable "conflict."

2. The FDCPA survives the Code even if parties had a "right" to file knowingly baseless claims. There is no conflict where a party can easily comply with each scheme by voluntarily refraining from targeted behavior. The Code creates a *permissive* right to file a claim; no one is compelled to take any act under the Code that is

forbidden by the FDCPA. The fact that professional debt collectors are singled out for additional regulation does not create a conflict; it merely reflects Congress's considered judgment that this particular group imposes heightened risks of public harm, and its behavior must be restricted in ways that do not affect ordinary creditors.

Congress intended the FDCPA to fill the gaps of other laws, and it does that here. Professional debt collectors are purchasing huge portfolios of knowingly stale claims, and flooding bankruptcy courts with claims that are undeniably unenforceable. While individual claims may impose little harm, the aggregate effect of this practice is staggering. Congress had every reason to impose additional restrictions on groups that tend to abuse the system to collect debts. It was aware that existing remedies were not always adequate to deter wrongful collection practices, and it intended the FDCPA to overlap with those schemes to provide added protection. The remedies available under the Code for *ordinary* creditors are not calibrated to handle the business methods of debt collectors. The FDCPA performs that role, and Midland errs in refusing to accept this superimposed scheme as Congress intended. The judgment should be affirmed.

ARGUMENT

I. THE FDCPA PROHIBITS KNOWINGLY FILING A PROOF OF CLAIM ON TIME-BARRED DEBT IN A CHAPTER 13 BANKRUPTCY

As the court of appeals correctly held, filing a knowingly time-barred proof of claim violates the FDCPA. 758 F.3d at 1256-1257. That is exactly what Midland has done here: it filed a proof of claim without any good-faith belief that it was an enforceable obligation. On its face,

the debt involved a transaction from over *twelve years* ago (May 28, 2003); the original creditor charged off the debt on January 5, 2004, still over a *decade* ago. Dkt. 1-1 at 3. The limitations period is only six years (at most), meaning the last chance to sue expired in May 2009. Dkt. 21 at 1 & n.1.

Midland submitted this proof of claim without any plausible legal theory that it should be paid out of estate funds. Midland's only hope was that the debtor may unwittingly "fail to object" and the trustee may "fail[] to fulfill its statutory duty to object to improper claims." *Crawford*, 758 F.3d at 1259 n. 5, 1261. The Code's automatic-allowance provision (11 U.S.C. 502(a)) would then force Johnson to "pay the debt from h[er] future wages as part of the Chapter 13 repayment plan, notwithstanding that the debt is time-barred and unenforceable in court." *Id.* at 1259. This renders Midland's actions "'unfair,' 'unconscionable,' 'deceptive,' and 'misleading' within the broad scope of § 1692e and § 1692f." *Id.* at 1260.

A. Midland Violates The FDCPA By Falsely Representing That Its Time-Barred Claims Are Valid And Enforceable When It Knows Exactly The Opposite Is True

The FDCPA "specifically prohibits the false representation of the character or legal status of any debt" (*McMahon*, 744 F.3d at 1020), which precisely describes Midland's conduct. Its claims are indisputably time-barred and unenforceable. Yet "[i]n the context of the Bankruptcy Code's automatic claims allowance process, the filing of a proof of claim amounts to an assertion that the underlying claim is enforceable and that the claimant is entitled to be paid out of the bankruptcy estate." *Feggins* v. *LVNV Funding LLC (In re Feggins)*, No. 13-11319-WRS, 2015 Bankr. LEXIS 2822, at *15-*16 (Bankr. M.D. Ala. Aug. 24, 2015).

Midland has abused this process and taken unfair advantage of default rules declaring its claims "prima facie" valid when it knows the opposite is true. Its conduct is misleading because some debtors will understandably assume that Midland's claims are indeed "valid" despite their patent unenforceability. And its conduct is deceptive because it includes these invalid claims in a busy process designed for legitimate claims—where it is hardly surprising that invalid claims get lost in the shuffle. This conduct squarely violates the FDCPA, and Midland's contrary contention is meritless.

1. Defendants misrepresent the "character" and "legal status" of time-barred debts. 15 U.S.C. 1692e, 1692e(2)(A), 1692e(10).

"Whether a debt is legally enforceable is a central fact about the character and legal status of that debt." *McMahon*, 744 F.3d at 1020. Under the Code's background rules, however, *all* claims are automatically deemed "prima facie" valid. *Gardner* v. *New Jersey*, 329 U.S. 565, 573 (1947); see also Fed. R. Bankr. P. 3001(f) ("A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim."); 11 U.S.C. 502(a).

Midland exploits these rules. It is aware that its claims are not properly entitled to a presumption of validity—indeed, quite the opposite. Yet Midland never discloses that its claims are "prima facie" *invalid* or makes any corrective statement to avoid deceiving the court or other parties. Cf. *McMahon*, 744 F.3d at 1021 ("Neither LVNV nor CMS gave a hint that the debts that they were trying to collect were vulnerable to an ironclad limitations defense."). Midland simply leverages "the misleading impression * * * that the debt collector can legally enforce [a] debt" that indisputably cannot be

enforced. *Crawford*, 758 F.3d at 1261; see also *Buchanan*, 776 F.3d at 396.

Midland seeks to excuse itself by saying the Rules did not *require* it to make any disclosures. Br. 28. But Midland is aware of the Code's default presumption, and it is aware of the obvious impression left by filing a proof of claim. By choosing to participate in the process, Midland is necessarily representing that its claims are enforceable. That deception violates the FDCPA: "[A] time-barred claim is unenforceable within the meaning of the Bankruptcy Code, so a debt collector who knowingly files such a claim in bankruptcy is falsely asserting that it is entitled to be paid." *Feggins*, 2015 Bankr. LEXIS 2822, at *16.

Midland also contends that its claims were literally true: it "accurately" recounted all the required information on a court-approved form and "made the required disclosures * * * correctly and completely." Br. 27-28. Perhaps so.[28] But "the statute outlaws more than just falsehoods"; "even a true statement may be banned for creating a misleading impression." *Buchanan*, 776 F.3d at 396 (Sutton, J.); see also *Gammon* v. *GC Servs. Ltd. P'ship*, 27 F.3d 1254, 1258 (7th Cir. 1994) (Easterbrook, J., concurring) ("literal truth may convey a misleading impression").

[28] Or perhaps not: Midland may have accurately stated the relevant facts of the transaction, but the filing itself is a bottom-line declaration that the claim is presumptively "valid" and entitled to be paid—which is the automatic result if no one objects. 11 U.S.C. 502(a). The unavoidable representation is that Midland was entitled to relief, which it knew was false. See *Robinson* v. *eCast Settlement Corp.*, No. 14-CV-8277, 2015 WL 494626, at *3 (N.D. Ill. Feb. 3, 2015) (a proof of claim bears "an implicit representation of legal enforceability").

Even were Midland's filings literally true, they still used deceptive *means* to foster the misleading impression that time-barred debts were enforceable. A professional debt collector cannot excuse itself by including half-truths about a debt's amount or age—Midland still wrongly included stale debts in a process reserved for *enforceable* claims.

Finally, Midland makes much of the fact that the Advisory Committee declined to require an affirmative statement regarding timeliness when it last amended Rule 3001(c). Br. 20-21, 28. But Midland again only tells half the story: The working group was concerned about *good-faith* claims where creditors were genuinely unsure about the timeliness of a claim; they were not giving a pass to creditors who knowingly file invalid claims. See *Agenda Book for the Meeting of the Advisory Committee on Bankruptcy Rules* 86-87, 90 (Mar. 26-27, 2009) <tinyurl.com/2009agenda> ("some members of the subcommittee believed that there are too many factors involved with a statute of limitations defense for a claimant to be able to affirmatively certify that it is inapplicable"). Indeed, the working group expressly recognized that Rule 9011 "imposes an obligation on a claimant" to undertake a reasonable pre-filing inquiry and determine that "a claim is warranted by existing law and that factual contentions have evidentiary support." *Id.* at 87. And the Advisory Committee again confirmed that claims complying with Rule 3001(c) "constitute[] prima facie evidence of the validity and amount of the claim." Fed. R. Bankr. P. 3001 advisory committee's notes (2012).

The resulting message is inescapable: The committee did not expect claimants to conduct a good-faith inquiry under Rule 9011 only to *ignore* the result and file baseless claims anyway—and they assuredly did not provide any reason to think that claims *found to be invalid*

should be deemed "prima facie" valid and enforceable. The rule amendments only confirm Midland's misconduct: it shows that Midland has no basis for filing defective claims in a process reserved for enforceable obligations, and it violates Rule 9011 by determining the untimeliness of its claims and then filing anyway. Its abusive scheme fits comfortably within the FDCPA, and nothing in the Code washes away its misrepresentations.[29]

2. Midland's conduct is also deceptive. Apart from the potential to mislead or confuse debtors who actually read the proof of claim, it also has the potential to slip through the process unnoticed. The very act of cloaking the claim with presumptions of "validity" reduces the odds that others engage in a studied review, spot the known defect, and object:

> The typical federal court disposes of hundreds of cases each year—a bankruptcy court disposes of thousands. It is not uncommon to see dozens of attorneys in a bankruptcy courtroom, presenting arguments and objections on a long list of cases, with rulings issuing at pace that makes a cattle auction appear lei-

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[29] Contrary to Midland's contention (Br. 27-29), *Sheriff* v. *Gillie*, 136 S. Ct. 1594 (2016), does not help its position. In *Sheriff*, the Court held that special counsel's use of agency letterhead did not "falsely" imply an affiliation with the Attorney General—because special counsel *was in fact affiliated with the Attorney General*. 136 S. Ct. at 1601-1602. The challenged "impression" was not false or misleading because the impression was *true*. *Id.* at 1602-1603. Here, however, the same *cannot* be said of Midland's proofs of claim. It makes no difference that those claims disclosed half-truths about the debts, because Johnson is not challenging those half-truths; again, she is challenging the core assertion that Midland's claims are valid and enforceable—facts Midland knew were false before it deliberately fostered the opposite impression with its claims.

> surely. A bankruptcy court does not have the time district courts devote to a motion, to examine each petition, proof of claim, and objection; the bankruptcy judge must rely on counsel to act in good faith. The potential for mischief to be caused by an attorney who is willing to skirt ethical obligations and procedural rules is enormous.

Young v. *Young (In re Young)*, 789 F.3d 872, 879 (8th Cir. 2015) (internal quotation marks omitted).

Midland takes advantage of this process to create the impression that its claims are valid and enforceable, thus misstating the "character" and "legal status" of the debt. 15 U.S.C. 1692e, 1692e(2)(A), 1692e(10). This again violates the FDCPA.

3. Midland argues that its conduct would not have misled or deceived a "competent attorney," and its conduct should be measured against that heightened standard. Br. 29-30 (opposing use of the "unsophisticated consumer" alternative); compare, *e.g.*, *Wallace* v. *Wash. Mut. Bank, F.A.*, 683 F.3d 323, 326 (6th Cir. 2012) (asking whether a "statement would tend to mislead or confuse the reasonable unsophisticated consumer"). Midland is incorrect.

Midland's representations are designed to deceive unrepresented debtors or mislead busy attorneys and trustees who have neither the time nor the resources to review invalid proofs of claim. Because the process often relies on consumer debtors as the ultimate backstop, Midland's representations should be reviewed on the assumption that the debtor herself (*not* her attorney) will review these claims. See *Evory* v. *RJM Acquisitions Funding L.L.C.*, 505 F.3d 769, 774 (7th Cir. 2007) (the FDCPA standard is "different when the conduct is aimed at a lawyer than when it is aimed at a consumer").

Indeed, Midland's communications are not directly aimed at lawyers. These are court filings in a busy process that *may or may not* be reviewed by attorneys. This fact is an essential component of Midland's scheme: If these communications *always* reached competent professionals (with time to review them), Midland's claims would be rejected 100% of the time, and Midland would stop misusing the claims-process.[30] Midland's business model critically relies on claims slipping through the process without any educated review. Given that Midland only collects when lawyers and trustees do *nothing*, it is a bit much for Midland to insist that those groups always review these claims.[31]

Nor is it relevant that Johnson herself was represented by an attorney. Contra Br. 30. This overlooks the FDCPA's private-attorney-general function. See, *e.g.*, *Tolentino* v. *Friedman*, 46 F.3d 645, 651-652 (7th Cir. 1995). The FDCPA is designed to avoid and deter abu-

[30] The only exception: There are instances where competent professionals do review Midland's meritless claims but simply acquiesce to avoid the cost of an objection. Those claims may not mislead or deceive anyone, but that hardly excuses Midland's misconduct: it is highly abusive to file frivolous claims knowing that the nuisance value will result in an illegitimate payout. Even if Midland somehow escapes liability under Section 1692e (due to the sheer obviousness of the defects in its filings), its misuse of the claims-process is still grossly unfair and unconscionable under Section 1692f.

[31] This accordingly is unlike a situation where a debt collector sends direct communications exclusively to attorneys. Midland's court filings can be viewed by anyone, including unrepresented debtors (as is sometimes the case). Had Midland somehow restricted its filings to a debtor's lawyer, it would at least have some basis for assessing liability under a heightened standard. But these filings were not *directed* at counsel; they were submitted to the court, in the hope that no one (most of all any competent lawyer) would ever review them.

sive practices. Plaintiffs who are *not* deceived are permitted (and encouraged) to file suit in order to protect consumers who would otherwise fall victim to debt-collector misconduct. See *Crawford*, 758 F.3d at 1258 ("[t]he inquiry is not whether the *particular* plaintiff-consumer was deceived or misled") (emphasis added). It is accordingly irrelevant that Johnson was represented. That is not always the case for many consumers, which is precisely why Midland continues exploiting the system. The FDCPA deters Midland from wasting everyone's time and serves as a safeguard for those consumers who cannot otherwise protect themselves.

B. Midland Violates The FDCPA By Exploiting The Claims-Allowance Process To Collect When The System *Malfunctions*, Not When It Operates As Congress Intended

Midland also violates the FDCPA by using "unfair or unconscionable means to collect or attempt to collect" time-barred debts. 15 U.S.C. 1692f. Midland succeeds only when the bankruptcy process breaks down and fails—as it routinely does. Its claims have no legitimate purpose: there are *zero* circumstances where Congress intended time-barred claims to divert funds from the estate. Midland simply exploits unintended flaws in the process, at the expense of vulnerable debtors and innocent creditors. Its scheme is "'unfair,' 'unconscionable,' 'deceptive,' and 'misleading' within the broad scope of § 1692e and § 1692f." *Crawford*, 758 F.3d at 1260.

1. Midland engages in a flagrant misuse of the bankruptcy process. As described above, proofs of claim are automatically "allowed" unless someone objects. 11 U.S.C. 502(a). Under this automatic-allowance procedure, all unchallenged claims—even patently *invalid* claims—are included by default in distributions. This permits the system to function efficiently. But it also

creates opportunities for abuse: creditors with defective claims can "unfairly game[] the system by taking advantage of the automatic claims allowance process," "camouflaging [their claims] among the inundation of other claims filed," and hoping to "slip past the bankruptcy court's supervision unnoticed." *Feggins*, 2015 Bankr. LEXIS 2822, at *16. These bad-faith actors know that if the process breaks down, they will illegitimately collect on unenforceable claims, flouting Congress's intent.

Most legitimate debt-collection efforts work within the system's intended operation; Midland's business model, by contrast, is predicated entirely on system failure.[32] Midland knowingly floods bankruptcy courts with time-barred claims in the hope of collecting unenforceable debts. These claims have no legal justification. *Avalos*, 531 B.R. at 757. Midland does not (and *cannot*) contend that it has any good-faith basis for these filings. Midland's only hope is that the system *malfunctions*: the debtor may unwittingly "fail to object" and the trustee may "fail[] to fulfill its statutory duty to object to improper claims." *Crawford*, 758 F.3d at 1259 n.5, 1261. When that happens, Midland can force debtors to "pay the debt from [their] future wages as part of the Chapter 13 repayment plan, notwithstanding that the debt is time-barred and unenforceable in court." *Id.* at 1259.

This scheme is "an abuse of the claims allowance process and an affront to the integrity of the bankruptcy

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[32] System failure is also all too predictable. Consumer debtors may review claims without an attorney, and many unrepresented debtors are unaware of limitations defenses. While trustees are likely aware of limitations defenses, they may not devote their limited time and resources to inspecting claims. Midland, by design, takes improper advantage of these predictable deficiencies.

court." *Feggins*, 2015 Bankr. LEXIS 2822, at *12. Midland imposes pointless costs on courts and innocent parties without any offsetting societal value or public benefit. In the best-case scenario, the debtor or trustee is burdened with the hassle and expense of filing needless objections, and the court is forced to waste its time and resources rejecting baseless claims; in the worst-case scenario, the process breaks down and allows invalid claims, diverting limited funds from vulnerable debtors and honest creditors. The process is sufficiently taxed without the deliberate filing of baseless claims. Midland's attempt to profit from system-error is unfair and unconscionable, and it violates the FDCPA.

2. Midland insists that its scheme is a fair and legitimate use of the bankruptcy process, but it is mistaken.

According to Midland, Congress *invited* parties to file knowingly time-barred claims. Br. 31. Yet as explained more below (Part II, *infra*), Congress did not invite or tolerate the filing of frivolous claims.

In practice, Midland effectively concedes that its knowingly time-barred claims are "baseless" or "frivolous." It is difficult to imagine a better characterization for a claim that is indefensible in court: once anyone lodges an objection, Midland immediately throws in the towel. It simply withdraws or abandons the stale claim, because it has no colorable basis for defending why it previously asserted a "right to payment." When a party asserts that it has a "valid" claim—when it knows it has an *invalid* claim—it has filed (in common parlance) a *frivolous* claim. See, *e.g.*, *Feggins*, 2015 Bankr. LEXIS 2822, at *15-*16.

Nor is Midland's practice somehow "fair" because its claims clearly state information that can be used to determine if the debt is time barred. Br. 32. This same information is available to *Midland*, who thus knew its

claims were time-barred but filed anyway. It is hardly an excuse that others—absent system failure—might figure out what Midland already knew before "burden[ing]" the system with frivolous claims. *In re Sekema*, 523 B.R. 651, 655 (Bankr. N.D. Ind. 2015) (sanctioning debt collectors with a fine "reflect[ing] an appreciation of the system-wide burdens created by this type of misconduct").

Moreover, Midland cannot offer a single legitimate reason that its participation actually benefits anyone—other than itself. It does not benefit the debtor, who is already protected from enforcement (time-barred debts are only "moral" obligations, not legal ones). See also Part II, *infra*. It does not benefit the trustee, who already has enough on her plate without wasting time and resources objecting to frivolous claims. It does not benefit legitimate creditors, whose proper share is diminished when the system wrongly permits recovery on time-barred debts. If the system operates without error, those debts will be categorically excluded. There is no universe in which the process is frustrated when debt collectors refrain from filing frivolous claims.

C. The Same Baseless Filings That Would Violate The FDCPA In State Court Also Violate The FDCPA In Bankruptcy

As even Midland effectively admits, it could not file time-barred claims in state court without violating the FDCPA. *Phillips*, 736 F.3d at 1079 (invoking 15 U.S.C. 1692e, 1692f); see also *Freyermuth* v. *Credit Bureau Servs., Inc.*, 248 F.3d 767, 771 (8th Cir. 2001). Midland, however, insists that it can sidestep the FDCPA by pursuing the same stale debt in bankruptcy, because bankruptcy is "different" and Chapter 13's "safeguards" protect debtors. Br. 34-38. Midland is wrong.

1. As the Eleventh Circuit held in *Crawford*, in every relevant respect, the reasons "for outlawing stale suits to

collect consumer debts" (*Phillips*, 736 F.3d at 1079) are "[t]he same * * * in the bankruptcy context." *Crawford*, 758 F.3d at 1260. Here, as in ordinary litigation, knowingly time-barred claims take unfair advantage of debtors, deliberately "creat[ing] the misleading impression" that debts can be enforced. *Id.* at 1261. Indeed, the entire point of Midland's scheme is to deceive debtors into "unwittingly" accepting stale debt. *Phillips*, 736 F.3d at 1079. Likewise, debtors will often give up rather than fight a frivolous claim: "filing objections to time-barred claims consumes energy and resources in a debtor's bankruptcy case, just as filing a limitations defense does in state court." *Crawford*, 758 F.3d at 1261. Here, as in state court, frivolous claims may survive simply because no one has sufficient incentive to oppose them.

"In bankruptcy," as in ordinary litigation, "the limitations period provides a bright line for debt collectors and consumer debtors, signifying a time when the debtor's right to be free of stale claims comes to prevail over a creditor's right to legally enforce the debt." *Crawford*, 758 F.3d at 1260-1261. The FDCPA "outlaw[s]" time-barred claims in state court (*Phillips*, 736 F.3d at 1079); there is no reason that Congress intended to provide *less* protection once debtors enter bankruptcy. See, *e.g.*, *Butner* v. *United States*, 440 U.S. 48, 55 (1979).

2. Midland, however, argues that Chapter 13 debtors are protected by attorneys and trustees. Midland insists that these safeguards operate effectively, but it has no answer for this simple question: If bankruptcy's safeguards always functioned, why are Midland's time-barred claims ever allowed? Midland failed to cite a *single* reason that its claims would ever survive a proper objection. So why does Midland recover with sufficient frequency to make this a viable business model?

The answer is obvious: Bankruptcy's "safeguards" are *not* adequate. Midland is well aware of the deficiencies in the process, because its entire practice turns on exploiting those deficiencies. If the process functioned as Congress intended, its claims would be rejected 100% of the time, and it would stop "flooding" the courts with frivolous claims.

Indeed, while Chapter 13 debtors are often represented by lawyers, not all consumer debtors have lawyers, and not all lawyers are retained to review claims or file objections. It is wrong to presume that attorneys retained for the overall bankruptcy have also been paid to review proofs of claim. And every time debtors are unrepresented (or a representation's scope is limited), debtors alone are forced to review claims and identify defenses. Those debtors are materially indistinguishable from debtors in state-court litigation.

Nor is it fair to ask debtors to hire attorneys to object to Midland's time-barred filings. See *Birtchman*, 2015 WL 1825970, at *9 (suggesting debtors would incur only "minimal" expense for "the additional legal work required" to challenge time-barred claims). The cost of even a few hundred dollars is a meaningful expense to Chapter 13 debtors—it can mean the difference in a debtor's ability to meet basic needs for herself and her family. And even if frivolous claims prompt only "straightforward" objections (*ibid.*; Pet. Br. 32), someone must still review the claim, confirm the limitations period, prepare the objection, and file that objection with the court, which must then review and adjudicate the issue. Even if that entire process consumes only an hour of everyone's time—an exceedingly low estimate—the aggregate cost of filing hundreds of thousands of claims quickly reaches staggering proportions. See, *e.g.*, *Jenkins* v. *Genesis Fin. Solutions, LLC (In re Jenkins)*, 456

B.R. 236, 241 (Bankr. E.D.N.C. 2011) ("The issue is a real one, the problem is widespread, and it burdens both debtors and the courts."). Given the lack of any redeeming value in Midland's practice, this significant expense is hardly warranted.[33]

Midland further insists that debtors are adequately protected by trustees: even with "unrepresented" debtors, trustees have an independent statutory obligation to object to improper claims, including those barred by the statute of limitations. Br. 31; see also *LaGrone* v. *LVNV Funding LLC (In re LaGrone)*, 525 B.R. 419, 426 (Bankr. N.D. Ill. 2015).

This logic flips the statutory scheme on its head. The FDCPA bans "abusive, deceptive, and unfair" practices. 15 U.S.C. 1692(a). Debt collectors cannot possibly avoid the FDCPA by suggesting that their practice is so egregious that Congress *compelled* trustees to ferret out and attack it. If these claims had any legitimate purpose, Congress would not have charged trustees with automatically objecting the moment the claims are filed. The trustees' "statutory obligation" only underscores precisely why this conduct violates the FDCPA; it hardly excuses it.

In any event, as a practical matter, trustees do *not* adequately protect debtors. Debt collectors know that trustees cannot feasibly object to every baseless claim. Trustees are charged with multiple duties and obligations, and they operate under difficult circumstances

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[33] In many situations, the cost of objecting to the time-barred debt quickly approaches the amount of the debt itself. See *Suesz* v. *Med-1 Solutions, LLC*, 757 F.3d 636, 639 (7th Cir. 2014) (en banc). Debt collectors are very aware of this dynamic, and it explains why many parties simply acquiesce in baseless filings rather than invest time and resources filing an objection.

with limited time and resources. In light of these practical constraints, trustees simply cannot wade through each and every proof of claim filed in all Chapter 13 proceedings. See *Feggins* v. *LVNV Funding LLC*, No. 13-11319-WRS, 2015 WL 7424339, at *3 n.5 (Bankr. M.D. Ala. Nov. 20, 2015) (*Feggins II*) (trustee "testified that his office processes between 6,000 and 7,000 claims each month, and that there are between 18,000 and 19,000 pending Chapter 13 cases in this district"). Midland deliberately exploits this dynamic.

3. Midland also argues that its practice does not typically harm debtors, undercutting the case for FDCPA liability: "In the event a claim for a time-barred debt is ultimately allowed, moreover, it will ordinarily have no effect on the debtor." Br. 35 (suggesting "additional allowed claim[s]" usually reallocate the same amount among all the creditors, rather than increasing what the debtor pays). This is false.

It is clearly incorrect for Chapter 13 debtors with 100% plans, who end up paying dollar-for-dollar a debt that is unenforceable outside bankruptcy. It is even wrong for debtors not repaying 100% of unsecured debt: If the bankruptcy case is dismissed or converted to Chapter 7, debtors would owe more on outstanding debts due to amounts wrongly diverted to stale claims. *In re Freeman*, 540 B.R. 129, 135 (Bankr. E.D. Pa. 2015). Midland suggests this is a rare occurrence, but this Court recently explained otherwise: "Many debtors, however, fail to complete a Chapter 13 plan successfully." *Harris* v. *Viegelahn*, 135 S. Ct. 1829, 1835 (2015) ("only one in three cases filed under Chapter 13 ends in discharge"). Moreover, Midland also overlooks the entire, common category of non-dischargeable debts: categories like "child support, alimony, and certain unpaid educational loans and taxes." *Grogan* v. *Garner*, 498 U.S. 279, 287

(1991). Every dollar devoted to a time-barred claim leaves an extra dollar unpaid on the non-dischargeable balance of those important debts.

Contrary to Midland's contention, it is very clear that its conduct exacts a real cost on debtors, not just other the courts and creditors (who also suffer as a result). This conduct is not tolerated outside bankruptcy, and there is no reason that it should be tolerated within it.

D. Midland's Conduct Created A Direct And Immediate Risk Of Concrete Harm, And Johnson Plainly Has Article III Standing To Challenge Midland's Conduct

In a single footnote, Midland argues that Johnson lacks Article III standing. Br. 36 n.7. There is a reason this argument is in a footnote. Unlike some "bare procedural violation[s]," *Spokeo, Inc.* v. *Robins*, 136 S. Ct. 1540, 1549 (2016), this conduct imposes a real risk of actual harm, and it forces debtors to take action to prevent tangible injury: as in all bankruptcies, due to the clockwork claims-allowance process, debt collectors would automatically collect from the estate unless someone objects, despite filing unenforceable claims. This imposes serious risks and costs on all debtors, including Johnson.[34] Again, any debtor with a 100% Chapter 13 plan—repaying the full amount of all unsecured debt—is necessarily injured by including time-barred debts in the plan. Every penny wrongly distributed is taken from the debtor. And even debtors not repaying 100% of unse-

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[34] It also imposes serious costs on honest creditors, but Plaintiff has standing even without seeking to vindicate those creditors' interests. Cf. 15 U.S.C. 1692(e) (the FDCPA is partly designed so "debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged").

cured debts face harm: If a stale claim had been allowed and her bankruptcy case were later dismissed (or converted to Chapter 7), she would owe more on her outstanding debts due to amounts wrongly diverted to Defendants. *Freeman*, 2015 WL 6735395, at *3. And, again, any amount diverted away from non-dischargeable debts comes directly out of the debtor's pocket.

Johnson was compelled to vindicate her rights to guarantee only legitimate creditors would be paid from her future earnings. This presents a distinct risk of concrete harm, and immediate action was required to protect Johnson's rights. Midland tried to collect the actual money coming from her actual wages that would otherwise pay down her actual debts. Contrary to Midland's unusual view, Johnson has standing even though Midland's attempt to abuse the process fell short.

II. MIDLAND IS ENGAGED IN A CLEAR ABUSE OF THE BANKRUPTCY PROCESS

According to Midland, debt collectors have a "right" to file time-barred proofs of claim, despite having no good-faith belief that these claims are actually enforceable. Midland is mistaken. There is no absolute "right" (in *any* functioning legal system) to file *losing* claims. Midland's position is at odds with the Code's plain text, clear structure, and legislative purpose. Its abusive conduct burdens the bankruptcy process and harms innocent parties; it has no social value or public benefit. Midland is engaged in a clear abuse of the bankruptcy system, and the Code accordingly does not shield its misconduct under the FDCPA.

A. As Matter Of Law And Logic, There Is No "Right To Payment" For Unenforceable Claims

Midland's assertion of a "right" to file time-barred claims is incompatible with the Code's plain text. A claim is defined as a "right to payment," 11 U.S.C. 101(5)(A),

and "[t]he plain meaning of a 'right to payment' is nothing more nor less than an *enforceable obligation*," *Pa. Dep't of Pub. Welfare* v. *Davenport*, 495 U.S. 552, 559 (1990) (emphasis added); accord *FCC* v. *NextWave Pers. Communs. Inc.*, 537 U.S. 293, 303 (2003); *Cohen* v. *de la Cruz*, 523 U.S. 213, 218 (1998); *Johnson* v. *Home State Bank*, 501 U.S. 78, 83-84 (1991). This Court has accordingly affirmed that only "enforceable" claims are authorized under 11 U.S.C. 101(5)(A), and it is axiomatic that stale claims are *not* "enforceable." See, *e.g.*, *Crawford*, 758 F.3d at 1261 (a time-barred claim is "unenforceable"); *McMahon*, 744 F.3d at 1020 (time-barred claims are not "legally enforceable"); *Huertas* v. *Galaxy Asset Mgmt.*, 641 F.3d 28, 32 (3d Cir. 2011) (the statute of limitations "renders [the debt] unenforceable"). Because Midland has no "right to payment," it also has no "right" to file these claims, and its contrary contention is baseless.

1. Midland responds (Br. 22 & n.5) that this Court did not mean what it plainly said in (repeatedly) limiting Section 101(5)(A)'s "right to payment" to an "enforceable obligation." While Midland hopes to distinguish these cases on their facts, it overlooks that each case shares a critical common feature: all the claims at issue, unlike those here, were *legally enforceable*. See, *e.g.*, *NextWave*, 537 U.S. at 303 (discussing an *enforceable* regulatory condition); *De La Cruz*, 523 U.S. at 218 (discussing an *enforceable* award of treble damages); *Johnson*, 501 U.S. at 83-84 (discussing an *enforceable* mortgage interest); *Davenport*, 495 U.S. at 559-600 (discussing an *enforceable* restitution obligation). This commonality underscores precisely what Midland's claim lacks—"nothing more *nor less*"—and why its theory is indefen-

sible under this Court's authoritative construction of the Code.[35]

Midland also argues that it still has a "right to payment" because Alabama's time-bar "extinguishes the remedy" but not the underlying debt. Br. 17. This is exactly backwards. State law may preserve the underlying obligation, but it is no longer an "*enforceable*" obligation. See Ala. Code § 6-2-30(a) ("[a]ll civil actions must be commenced * * * within the period prescribed in this article *and not afterwards*") (emphasis added); *Huertas*, 641 F.3d at 32 ("Huerta's debt obligation is not extinguished by the expiration of the statute of limitations, *even though the debt is ultimately unenforceable in a court of law*") (emphasis added). Time-barred claims impose *moral* obligations, not legal ones. "[S]ome people might consider full debt re-payment a moral obligation even though the legal remedy for the debt has been extinguished," but the claim itself is not "legally enforceable." *McMahon*, 744 F.3d at 1020; see also *Crawford*, 758 F.3d at 1261 (time-barred claims are "unenforceable").[36]

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[35] Midland says that *Davenport* shows "a 'claim' can exist under the Code regardless of the creditor's ability to obtain a monetary judgment." Br. 22. But Johnson's point is not that all debts must be enforceable via "monetary judgment," but that there must be *some means of enforcing the debt*. *Davenport* identified a legal "enforcement mechanism" that guaranteed a "right to payment," thus satisfying *Davenport*'s own standard. 495 U.S. at 559-560. Midland's problem is not simply that it cannot enforce its claim in a civil proceeding, though it plainly cannot, see, *e.g.*, *Phillips* v. *Asset Acceptance, LLC*, 736 F.3d 1076, 1079 (7th Cir. 2013); Midland's problem is that it cannot enforce its claim *anywhere*.

[36] The plain language of Alabama's limitations provision further eliminates any argument that time-barred debts are "enforceable" until the debtor objects. On its face, Alabama's time-bar expressly applies to actions *before* they are filed. While defendants might acci-

Parties have no right to share in an estate's limited assets—and divert funds from legitimate creditors—based on a "moral" obligation alone. Unless the "right" is "enforceable," it does not qualify under the Code. Because Midland has no corresponding "right to payment," it has no basis for filing a proof of claim under Section 501(a).[37]

2. Nor is Midland correct that this settled law somehow contradicts this Court's pronouncements that "rights to payment" are defined by state law, not federal law. Br. 16-17. Federal law defines "right to payment" as a legally "enforceable" right; state law determines whether a right is legally enforceable. That leaves the federal statute with its (unitary) federal meaning, while still letting "state law govern[] the substance of claims." *Travelers Cas. & Surety Co. of Am.* v. *Pac. Gas & Elec. Co.*, 549 U.S. 443, 450 (2007) (internal quotation marks omitted); see also *ibid.* ("Accordingly, when the Bankruptcy Code uses the word 'claim'—which the Code itself

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dentally forfeit or waive that protection (by malpractice or mistake), the debt is unenforceable when the claim is wrongly filed.

[37] Midland asserts that a "proof of claim" under 11 U.S.C. 501(a) must include *knowingly unenforceable claims* because 11 U.S.C. 502(b)(1) says that a "claim" can be rejected as "unenforceable." Br. 19. This is mere semantics (and bad semantics at that): That same section, using the same words, is invoked to reject *fraudulent* claims, yet no one seriously maintains that a fabricated debt is a "claim." Congress did not have to write "purported" claim in Section 502(b)(1) to convey its obvious intent. Further, Section 501(a) is restricted (for the reasons discussed above) to claims supported by a good-faith belief in their enforceability. Even if a "claim" did not mean what this Court has said it means, the Code's structure—including Section 502(b)(1)'s procedure for striking time-barred claims—underscores that Congress did not permit parties to abuse the claims-process by filing knowingly indefensible claims.

defines as a 'right to payment'—it is usually referring to a right to payment recognized under state law.") (internal citation omitted). As with virtually all other States, Alabama says that debts are *not* legally enforceable after the limitations period expires, even if the underlying obligation remains. See, *e.g.*, *Ex parte Liberty Nat'l Life Ins. Co.*, 825 So.2d 758, 765 (Ala. 2007). Midland simply misunderstands the import of this common distinction. See, *e.g.*, *Buchanan* v. *Northland Group, Inc.*, 776 F.3d 393, 396-397 (6th Cir. 2015) (Sutton, J.) (recognizing the difference between the debt itself and its enforceability); *McMahon*, 744 F.3d at 1020 (Wood, C.J.) (same); *Huertas*, 641 F.3d at 32 (same).

3. Midland asserts that Congress intended for "claim" to be defined in the "'broadest possible'" manner, so any definition that excludes stale claims is necessarily wrong. Br. 16. Yet "broadest possible" does not mean limitless or incoherent. Congress expanded the definition of "claim" in important respects, but those respects were *enumerated*: things like "liquidated," "unliquidated," "fixed," "contingent," "unmatured," and "disputed." See, *e.g.*, *In re Charter Co.*, 876 F.2d 866, 869 (11th Cir. 1989) (explaining how Congress expanded the definition by "using the following broad language"). Stale claims fall outside this statutory category. Language suggesting that "disputed" claims can be filed hardly suggests that *indisputably invalid* claims may be filed. Those claims are already resolved as a legal matter; they are not "contingent," "disputed," or "unmatured"—they are simply (and indisputably) *unenforceable*. While the Code's definition captures "all *legal* obligations of the debtor, no matter how remote or contingent" (*ibid.*) (emphasis added), Congress did not capture solely "moral" obligations, which is all Midland now pursues.

Moreover, while the Code's definition of "claim" is indeed broad, Midland misunderstands Congress's objective: it wanted a process that could afford complete relief, so that "all *legal obligations* * * * will be able to be dealt with in the bankruptcy case." *Epstein* v. *Official Comm. of Unsecured Creditors of Estate of Piper Aircraft Corp.*, 58 F.3d 1573, 1576 (11th Cir. 1995). In a world in which parties could not file contingent or unmatured claims, parties would be shut out of the bankruptcy proceeding. H.R. Rep. No. 95-595, at 180 (1977). They could not share in the bankruptcy estate, and the debtor could not obtain full relief or a fresh start. Once those unresolved claims ripen, the debtor could be thrown back into debt, threatening the viability of any Chapter 13 plan and frustrating bankruptcy's objective.

Congress eliminated those concerns by widening the scope of "claims" to capture all claims with a "right to payment"—*i.e.*, an *enforceable obligation*. But nowhere did Congress suggest that this new definition of "claim" was intended to sweep in knowingly *invalid* claims. The goal was to bring all legitimate interests before the bankruptcy court. A party with a knowingly stale claim does not have any *legitimate* interest. It simply hopes to divert funds from the estate without any legal "right to payment." That behavior harms debtors and creditors alike, and there is no indication that Congress intended anyone to burden the process with such meritless claims.

Midland argues that the Code must not bar all unenforceable claims, as the Code "expressly brings claims that are not presently enforceable into the bankruptcy proceeding." Br. 18 (discussing claims that are "'contingent,' 'unmatured,' and 'disputed'"). This poses the wrong question: The Code asks whether the *obligation* is enforceable, not whether that obligation gives rise to an immediate right to sue in court. Consider, for example, a

"contingent" contract. It creates an *enforceable obligation* even if the contingency has not yet occurred. If one party disavows any future intent to perform, the other side assuredly can sue for breach.

Again, it makes sense that Congress deliberately captured all *enforceable* obligations to avoid the situation where claims ripening after bankruptcy (i) disrupt the debtor's fresh start or (ii) fail to receive a fair share of the estate (since the estate was already distributed). Neither of those concerns apply to Midland's time-barred debt, which will *never* ripen into an enforceable obligation.[38]

In short, Midland repeatedly insists that it has a "right to payment," but it cannot identify that right by *ipse dixit*; it failed to identify a single, non-voluntary, legal means of enforcing the time-barred debt. Midland can ask nicely to be repaid, but a debtor has every right to simply refuse. The lack of remedy eliminates the "right to payment," and Midland ignores the "plain meaning" of those words in suggesting otherwise. *E.g.*, *Davenport*, 495 U.S. at 559.[39]

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[38] Midland maintains that Johnson's position would "erode" the Code's protections in the automatic stay. Br. 23. First, while Midland is correct that 11 U.S.C. 362(a)(6) only applies to "claims," Midland does not mention 11 U.S.C. 362(a)(3)—which arguably precludes *any* attempt to control estate property, including attempts to collect time-barred debts. Second, unenforceable debts were not the concern or focus of the Code. Debtors are "overburdened" by *enforceable* claims, not stale claims. The automatic stay prevents parties with actual *rights* from jumping ahead in line; a debtor does not obviously need relief from time-barred claims. *Harris*, 135 S. Ct. at 1835.

[39] While Johnson believes that the best reading of "claim" excludes time-barred debts, it is easy to address Midland's concerns by recognizing "claims" to include time-barred debts, but also rec-

B. A Purported "Right" To File Time-Barred Claims Is Directly At Odds With The Code's Structure And Purpose

Midland's argument is also at odds with the structure and purpose of the Code. Debt collectors have no "right" to file knowingly time-barred claims.

First, the notion that parties have a "right" to file stale claims is directly at odds with the trustee's statutory duty to *object* to stale claims. See 11 U.S.C. 704(a)(5), 1302(b)(1). There is no reason to think that Congress embraced the pointless exercise of authorizing creditors to file a time-barred claim just so the trustee could immediately object to the same claim. Bankruptcies are sufficiently busy without make-work.

Midland's business practice wastes limited judicial and party resources with no offsetting public benefit. There is no societal value to permitting a debt collector to purchase time-barred debts for pennies on the dollar, all in the hope of flooding bankruptcy courts with "hundreds of delinquent accounts" and "unenforceable" claims. *Id.* at 1256. That does not advance the "just, speedy, and inexpensive determination of every case and proceeding." Fed. R. Bankr. P. 1001; see also, *e.g.*, *In re Sekema*, 523 B.R. 651, 655 (Bankr. N.D. Ind. 2015) (sanctioning debt collectors for filing knowingly time-barred claims, and imposing a fine that "reflects an appreciation of the system-wide burdens created by this type of misconduct").

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ognizing that parties cannot *file* a proof of claim without a good-faith basis. This preserves the automatic stay and permits the discharge of stale debts (where debtors schedule those debts to whatever gain), but does not permit the continued abuse of the bankruptcy process by the flood of knowingly time-barred claims.

Put simply: Why would any rational legislative body simultaneously grant an absolute "right" for one party to file a claim that another party has an absolute duty to reject? These time-barred claims will fail, by design, unless the trustee fails to discharge her legal obligations. That statutory design is incompatible with a purported "right" to file unenforceable claims.

Second, the entire point of the claims-process—as reflected by multiple Code provisions—is to efficiently and fairly process claims. That process is frustrated by attempts to bog down bankruptcy proceedings with knowingly invalid claims. Congress, again, would not have tasked trustees with a statutory duty to object to stale claims (11 U.S.C. 704(a)(5), 1302(b)(1)), only so debt collectors could try to slip them through. Nor would Congress have declared time-barred claims unenforceable (11 U.S.C. 502(b)(1), 558) if it wished parties to *knowingly* file unenforceable claims: there is sufficient work in every bankruptcy without inviting claims that are doomed for failure. And Congress would not have deemed claims "prima facie valid"—and presumptively enforceable—if it intended parties to file knowingly *invalid and unenforceable* claims. Compare *Gardner*, 329 U.S. at 573; Fed. R. Bankr. P. 3001(f).

The process is designed to function when all parties act in good faith; it is not designed to tolerate parties who abuse the system by filing meritless claims, all in the hope that the system breaks down and no one notices. *Young*, 789 F.3d at 879.

Nor is it necessary to include time-barred claims to achieve the primary goals of bankruptcy: a fresh start for the debtor and an equitable distribution of estate assets. A debtor does not need a fresh start from time-

barred debts; the *time-bar itself* provides the fresh start.[40]

Nor is it necessary to discharge debts to avoid future harassment from debt collectors: any debtor concerned about cutting off requests for *voluntary* repayment can always invoke 15 U.S.C. 1692c(c)—"[i]f a consumer notifies a debt collector in writing that the consumer refuses to pay a debt or that the consumer wishes the debt collector to cease further communication with the consumer, the debt collector shall not communicate further with the consumer." This FDCPA provision replicates the core effect of the discharge injunction.

Likewise, stale claims are unnecessary for the equitable distribution of estate assets. The "equitable distribution" on time-barred debt is *always* zero. Those debts are unnecessary to any functioning Chapter 13 plan. They are submitted only to take unfair advantage of the process in the hope of collecting when the system malfunctions. The multiple protections built into the system to *weed out* stale claims confirms that Congress did not want to usher in those same claims. Midland's contrary view is impossible to square with the structure or purpose of the Code.

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[40] Midland also suggests that a discharge is necessary to avoid the exceedingly unlikely scenario that a debtor may somehow be subject to an unknown future suit in some hypothetical jurisdiction with a longer limitations period and no borrowing statute. Br. 25. Suffice it to say that this chain of events was unlikely on Congress's mind in deciding whether to endure the risk of not discharging stale debts. Moreover, there is no realistic concern of debtors facing discrimination for not paying stale debts (contra Pet. Br. 25); Midland overlooks other subsections of 11 U.S.C. 525 that provide expansive anti-discrimination coverage in the broadest swath of likely situations.

Finally, Midland's argument is out of step with baseline norms of good faith and acceptable litigation conduct. More specifically, courts routinely award sanctions for filing knowingly time-barred claims: "Where an attorney knows that a claim is time-barred and has no intention of seeking reversal of existing precedent, as here, he makes a claim groundless in law and is subject to Rule 11 sanctions." *Brubaker* v. *City of Richmond*, 943 F.2d 1363, 1385 (4th Cir. 1991); see also, *e.g.*, *FDIC* v. *Calhoun*, 34 F.3d 1291, 1299 (5th Cir. 1994); *White* v. *GM Corp.*, 908 F.2d 675, 682 (10th Cir. 1990).

That describes Midland's conduct exactly. Midland purchased time-barred debts at pennies on the dollar precisely because those debts are unenforceable. The affirmative defense is "blindingly obvious": "coming to the conclusion that the claims might be time-barred did not require either claimant to look beyond the information it already possessed." *Sekema*, 523 B.R. at 654. Nor does it matter that "the statute of limitations is an affirmative defense which must be pled or waived" (*Steinle* v. *Warren*, 765 F.2d 95, 101 (7th Cir. 1985)): "Rule 11 does not permit a plaintiff to avoid sanctions merely because the opposing party or the judge might not immediately recognize that the assertion is groundless." *Brubaker*, 943 F.2d at 1385; *Leeds Bldg. Prods.* v. *Moore-Handley, Inc. (In re Leeds Bldg. Prods.)*, 181 B.R. 1006, 1010 (Bankr. N.D. Ga. 1995); see also *In re Excello Press, Inc.*, 967 F.2d 1109, 1112-1113 (7th Cir. 1992).[41]

[41] Alabama law applies materially indistinguishable principles: "It is one thing to file a lawsuit where the claim is of debatable legitimacy or where the defense is doubtful, but it is quite another to file a claim knowing it to be without merit or knowing that there exists a complete defense. The court system exists for the resolution of gen-

Sanctions, in short, are "appropriate if any attorney knowingly file[s] suit on an undisputedly time-barred claim." *Goins* v. *JBC & Assocs., P.C.*, 352 F. Supp. 2d 262, 272 (D. Conn. 2005). That proposition is impossible to square with Midland's alleged "right" to file time-barred claims. The entire point of a sanction is that conduct is not merely prohibited, but so egregious to warrant *punishment*. There is no such thing as a "right" to engage in sanctionable conduct. See *Feggins*, 2015 Bankr. LEXIS 2822, at *18; *Smith* v. *Asset Acceptance, LLC*, 510 B.R. 225, 226 (S.D. Ind. 2013).

Congress legislates against the backdrop of established principles like Rule 11 authority and inherent judicial power to sanction frivolous behavior. See *Fogerty* v. *Fantasy, Inc.*, 510 U.S. 517, 534 (1994). It follows that whatever "right" Congress conferred in the Code presumptively does not extend to frivolous filings. If Congress intended to create a "right" for debt collectors to file time-barred claims (without any discernible justification), Congress surely would have done so with clearer language than this.

III. MIDLAND CANNOT MEET ITS HEAVY BURDEN OF ESTABLISHING THAT THE BANKRUPTCY CODE REPEALS THESE FDCPA CLAIMS

"'[W]hen two statutes are capable of coexistence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective.'" *J.E.M. Ag Supply, Inc.* v. *Pioneer Hi-Bred*

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uine disputes, and must not be used as a means of coercing a party either to pay a debt that he does not owe or be compelled to expend a greater sum to defend an illegitimate claim." *Empiregas, Inc.* v. *Feely*, 524 So.2d 626, 628 (Ala. 1988) (so holding in the context of a malicious-prosecution suit based on the filing of a knowingly time-barred claim).

Int'l, Inc., 534 U.S. 124, 143-144 (2001); *Morton* v. *Mancari*, 417 U.S. 535, 550 (1974). Midland effectively concedes there is not a single line of text in the Code or the FDCPA that expressly precludes the claims at issue. Midland thus can prevail only by showing this is one of the "rare" occasions where one independent federal enactment precludes another. *Randolph* v. *IMBS, Inc.*, 368 F.3d 726, 730 (7th Cir. 2004). It most certainly is not.

First, as established above, a debt collector "can easily satisfy both mandates" (*Dep't of Trans.* v. *Pub. Citizen*, 541 U.S. 752, 767 (2004)), because the challenged conduct is forbidden under both schemes. Any debt collector who refuses to violate the Code will automatically comply with the FDCPA. There is no "positive[] repugnan[cy]" between these laws, and thus no preclusion.

Second, even if the Code somehow tolerated Defendants' conduct, there is still no "irreconcilable conflict": The claims-process is wholly permissive; no one is compelled to file a claim. Put another way: even if the Code permits Defendants' abusive conduct, it certainly does not *require* it. Thus, it cannot effect a repeal of the FDCPA by implication. There is no "irreconcilable conflict" when one scheme allows what the other forbids; one must *compel* what the other forbids. The standard is one of impossibility. *J.E.M.*, 534 U.S. at 142; *Randolph*, 368 F.3d at 730. Midland has not identified a single controlling case suggesting that a true "conflict" exists where one statute merely permits what another disallows. Mere tension may be relevant in a *preemption* analysis, but not a *preclusion* analysis. See *POM Wonderful LLC* v. *Coca-Cola Co.*, 134 S. Ct. 2228, 2236 (2014). Each law operates within its proper sphere to regulate its targeted behavior. See *POM Wonderful*, 134 S. Ct. at 2239-2240; *Conn. Nat'l Bank* v. *Germain*, 503 U.S. 249, 253 (1992).

"When two statutes complement each other, it would show disregard for the congressional design to hold that Congress nonetheless intended one federal statute to preclude the operation of the other." *POM Wonderful*, 134 S. Ct. at 2238. Midland's contrary view reflects a fundamental departure from well-settled doctrine.[42]

Midland hints that authorizing these FDCPA claims will flood courts with unnecessary litigation. Yet exactly the opposite is true: it is *debt collectors*, not debtors, who are creating needless work for innocent parties and busy courts. Once it is clear that courts will enforce the FDCPA as Congress intended, parties like Midland will have no choice but to respect the process and end their abusive tactics. The entire point of the FDCPA is to stop unfair practices before they begin. Without the FDCPA's deterrent, Midland has no reason to stop a practice that exacts significant costs without any redeeming benefit. These suits will deter that future misconduct, eliminating the need to expend *any* further effort grappling with baseless claims.

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[42] Midland further relies on *Kokoszka* v. *Belford*, 417 U.S. 642 (1974), a case definitively rejected as irrelevant by multiple. As those circuits explained, this Court's statements were "at minimum dicta," and at most a "gloss" on a separate issue entirely. *Simon*, 732 F.3d at 278 (describing the "garnishment provisions" in *Kokoszka*). Under the FDCPA, the question is "how debt collectors interact with debtors," not "what assets are made available" in bankruptcy. *Randolph*, 368 F.3d at 731 (likewise distinguishing *Kokoszka*). The concerns animating the FDCPA apply with full force in this context.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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DECEMBER 2016

American Bar Association
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No. 16-348

In the Supreme Court of the United States

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v.

ALEIDA JOHNSON

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BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING RESPONDENT

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QUESTION PRESENTED

Whether a creditor violates the Fair Debt Collection Practices Act (FDCPA), 15 U.S.C. 1692 *et seq.*, by filing an accurate proof of claim in a bankruptcy proceeding for an unextinguished time-barred debt that the creditor knows is judicially unenforceable.

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INTEREST OF THE UNITED STATES

The Fair Debt Collection Practices Act (FDCPA or Act), 15 U.S.C. 1692 *et seq.*, authorizes the Consumer Financial Protection Bureau (CFPB) to "prescribe rules with respect to the collection of debts by debt collectors, as defined in [the FDCPA]." 15 U.S.C. 1692*l*(d). The CFPB, the Federal Trade Commission (FTC), and other federal agencies are responsible for enforcing the Act through administrative proceedings and civil litigation. 15 U.S.C. 1692*l*(a)-(c). In addition, United States Trustees, who are appointed by the Attorney General, are charged with supervising the administration of bankruptcy cases. 28 U.S.C. 581-589a. The United States therefore has a substantial interest in the Court's resolution of the question presented.

STATEMENT

1. a. Congress enacted the FDCPA in 1977 in response to "abundant evidence of the use of abusive, deceptive, and unfair debt collection practices by many debt collectors." 15 U.S.C. 1692(a). Congress found that "[e]xisting laws * * * are inadequate to protect consumers," and that "the effective collection of debts" does not require "misrepresentation or other abusive debt collection practices." 15 U.S.C. 1692(b) and (c). The Act accordingly subjects a "debt collector"—a defined term that refers to "third-party collectors of consumer debts," *Sheriff* v. *Gillie*, 136 S. Ct. 1594, 1598 (2016)—to various procedural and substantive requirements that are designed to "eliminate abusive debt collection practices" and to "insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged," 15 U.S.C. 1692(e).

The Act prohibits debt collectors from, *inter alia*, "us[ing] any false, deceptive, or misleading representation or means in connection with the collection of any debt," 15 U.S.C. 1692e, and specifically bars debt collectors from making a "false representation of * * * the character, amount, or legal status of any debt," 15 U.S.C. 1692e(2)(A). The Act further provides that "[a] debt collector may not use unfair or unconscionable means to collect or attempt to collect any debt." 15 U.S.C. 1692f. The Act authorizes civil actions against "any debt collector who fails to comply with any provision of [the FDCPA] with respect to any person." 15 U.S.C. 1692k.

b. Petitioner is a debt collector that regularly purchases accounts with overdue balances and attempts to collect the past-due amounts. Pet. App. 3a. "Debt

collection is a $13.7 billion dollar industry," consisting of "approximately 6,000 collection agencies" and affecting approximately "35% of Americans, more than 77 million people." CFPB, *Fair Debt Collection Practices Act: CFPB Annual Report 2016*, at 8 (Mar. 2016).[1] A "substantial part" of the debt-collection business involves "debt buying." *Id.* at 10; see FTC, *Collecting Consumer Debts: The Challenges of Change* 13 (Feb. 2009).[2] Debt buying typically involves bundling debt into portfolios that "generally share common attributes," including "the type of credit issued" and "the elapsed time since the consumer accounts went into default." FTC, *The Structure and Practices of the Debt Buying Industry* 17 (Jan. 2013) (2013 FTC Report).[3] "[D]ebt buyers generally pa[y] less for older debts than for newer ones." *Id.* at 23. One FTC analysis of debt-buying practices from 2006 to 2009 shows that debt buyers paid on average 7.9 cents per dollar for debts less than three years old, 3.1 cents per dollar for debts three to six years old, 2.2 cents per dollar for debts six to 15 years old, and effectively nothing for debts more than 15 years old. *Id.* at 22-24.

c. Every State has adopted a limitations period for suits to collect unpaid debts. See, *e.g.*, Fred O. Williams, *State statutes of limitation for credit card debt*[4] (col-

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[1] http://files.consumerfinance.gov/f/201603_cfpb-fair-debt-collection-practices-act.pdf.

[2] https://www.ftc.gov/sites/default/files/documents/reports/collecting-consumer-debts-challenges-change-federal-trade-commission-workshop-report/dcwr.pdf.

[3] https://www.ftc.gov/sites/default/files/documents/reports/structure-and-practices-debt-buying-industry/debtbuyingreport.pdf.

[4] http://www.creditcards.com/credit-card-news/credit-card-state-statute-limitations-1282.php (last updated July 12, 2016).

lecting state laws). Although limitations periods vary, most are between three and six years, and no State has a limitations period longer than 15 years. 2013 FTC Report 42. Expiration of a limitations period typically does not extinguish a debt, but it precludes the creditor from recovering on the debt through the use of judicial processes.[5] *Ibid.* In most States, a consumer must invoke the statute of limitations as an affirmative defense. *Id.* at 45.

2. A debtor commences a voluntary bankruptcy case by filing a petition in bankruptcy court. 11 U.S.C. 301. Individual debtors typically file for relief under Chapter 7 of the Bankruptcy Code (Code), which provides for a liquidation of a debtor's non-exempt assets in exchange for a discharge of pre-petition debts, 11 U.S.C. 701 *et seq.*; or under Chapter 13, which provides for the adjustment of debts of an individual with regular income, 11 U.S.C. 1301 *et seq.* An individual debtor must file with the bankruptcy petition, *inter alia*, a list of his secured and unsecured creditors. 11 U.S.C. 521(a)(1)(A); Fed. R. Bankr. P. 1007(a); U.S. Courts, *Bankruptcy Forms: 106D and 106E/F*. The Code defines "creditor" to mean any "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor." 11 U.S.C. 101(10)(A). The term "claim" is defined to include a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. 101(5)(A). This Court has

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[5] In Mississippi and Wisconsin, the expiration of a limitations period for collecting a debt extinguishes the debt. Miss. Code Ann. § 15-1-3 (Supp. 2011); Wis. Stat. Ann. § 893.05 (West 1997).

explained that "[t]he plain meaning of a 'right to payment' is nothing more nor less than an enforceable obligation." *Pennsylvania Dep't of Pub. Welfare* v. *Davenport*, 495 U.S. 552, 559 (1990).

A creditor with a claim against a debtor "may file a proof of claim," 11 U.S.C. 501(a), which consists of a "written statement setting forth a creditor's claim," Fed. R. Bankr. P. 3001(a). A "proof of claim executed and filed in accordance with [the Federal Rules of Bankruptcy Procedure] shall constitute prima facie evidence of the validity and amount of the claim," Fed. R. Bankr. P. 3001(f), and the claim is "deemed allowed" unless a party in interest to the bankruptcy proceeding (*e.g.*, the debtor, the trustee, or another creditor) files an objection to the claim, 11 U.S.C. 502(a).

The Code establishes a mechanism for disallowing unenforceable claims. Any party in interest may object to a proof of claim, 11 U.S.C. 502(a), and the trustee in a Chapter 13 bankruptcy "shall," "if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper," 11 U.S.C. 704(a)(5), 1302(b)(1). When a party objects to a claim that "is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured," the bankruptcy court must disallow it. 11 U.S.C. 502(b)(1). The Code further specifies that the bankruptcy estate (which is created when a debtor files a bankruptcy petition) "shall have the benefit of any defense available to the debtor as against any entity other than the estate, including statutes of limitation." 11 U.S.C. 558.

3. a. In March 2014, respondent filed a Chapter 13 bankruptcy petition. Pet. App. 3a. Several months later, petitioner filed a proof of claim in respondent's bankruptcy, seeking repayment of $1879.71. *Ibid.* Petitioner had purchased that debt from Fingerhut Credit Advantage. *Ibid.* The last transaction on that account was in May 2003, and the applicable statute of limitations for a creditor to collect on that debt is six years. *Ibid.*; Ala. Code § 6-2-34 (LexisNexis 2014). Respondent objected to the proof of claim on the ground that it did not contain supporting documentation, J.A. 21, and the bankruptcy court disallowed the claim, see J.A. 10 (Docket entry No. 22).

b. Respondent sued petitioner in the United States District Court for the Southern District of Alabama, alleging that petitioner's filing of a proof of claim for time-barred debt violated the FDCPA because it was deceptive and misleading under Section 1692e and was unfair and unconscionable under Section 1692f. Pet. App. 3a-4a, 19a; see J.A. 23-28. Petitioner moved to dismiss, arguing that the Bankruptcy Code precluded any right to relief the FDCPA otherwise might give respondent, and that respondent's allegations failed in any event to state a claim under the FDCPA. Pet. App. 19a.

The district court granted petitioner's motion to dismiss. Pet. App. 18a-37a. The court acknowledged that, under circuit precedent, the filing of a proof of claim in bankruptcy for a time-barred debt violates the FDCPA. *Id.* at 19a (citing *Crawford* v. *LVNV Funding, LLC*, 758 F.3d 1254, 1256-1257 (11th Cir. 2014), cert. denied, 135 S. Ct. 1844 (2015)). The court held, however, that this prohibition was in irreconcilable tension with the Bankruptcy Code provision

permitting a creditor to file a proof of claim. *Id.* at 20a-37a. The district court concluded that the Code had impliedly repealed the relevant prohibitions in the FDCPA, at least as applied to the filing of a proof of claim for an unextinguished debt that a creditor knows is time-barred. *Id.* at 31a n.17.

c. The court of appeals reversed and remanded. *Id.* at 1a-15a. The court stated "that the Code allows creditors to file proofs of claim that appear on their face to be barred by the statute of limitations." Pet. App. 7a. It held, however, that "when a particular type of creditor—a designated 'debt collector' under the FDCPA—files a knowingly time-barred proof of claim in a debtor's Chapter 13 bankruptcy, that debt collector will be vulnerable to a claim under the FDCPA." *Ibid.*

The court of appeals held that the doctrine of implied repeal had no application in this case because "[t]he FDCPA and the Code are not in irreconcilable conflict." Pet. App. 11a. The court explained that the two statutes, which "provide different protections and reach different actors," "can be reconciled" because "[t]he Code establishes the ability to file a proof of claim, while the FDCPA addresses the later ramifications of filing a claim." *Id.* at 12a (internal citation omitted). The court further explained that, "when a debt collector, as specifically defined by the FDCPA, files a proof of claim for a debt that the debt collector knows to be time-barred, that creditor must still face the consequences imposed by the FDCPA for a 'misleading' or 'unfair' claim." *Id.* at 13a. The court also emphasized that the FDCPA contains a "safe harbor for creditors who may file proofs of claim that are time-barred, if those filings arose from a good-faith

belief resulting from a recording error that the statute of limitations had not in fact run on the claim." *Id.* at 14a n.1 (citing 15 U.S.C. 1692k(c)).

SUMMARY OF ARGUMENT

The FDCPA prohibits a debt collector from filing a proof of claim in a bankruptcy for a debt that the debt collector knows is time-barred.

A. Outside bankruptcy, a plaintiff who knowingly files a time-barred suit is subject to sanctions for litigation misconduct. That is so even though most jurisdictions treat expiration of a statute of limitations as an affirmative defense. In the debt-collection context, a plaintiff will typically be well-positioned to ascertain the facts needed to determine whether a suit is timely. When a debt collector sues or threatens to sue to collect a debt it knows is time-barred, it violates the FDCPA's prohibitions on "misleading" representations and on "unfair" means of debt collection. That understanding accords with the consistent holdings of the federal courts of appeals that have addressed the issue.

B. The same general rules apply in bankruptcy. Contrary to petitioner's argument, the Code does not authorize the filing of a proof of claim for a debt that the creditor knows is unenforceable under applicable law. The Code directs that a claim for a time-barred debt should be disallowed. A creditor that knowingly files such a claim is subject to sanctions under Federal Rule of Bankruptcy Procedure 9011, and potentially to other remedies for bankruptcy abuse. The fact that the Code contains other mechanisms designed to prevent such claims from actually being paid does not alter that conclusion.

In bankruptcy as in other contexts, the FDCPA prohibits a debt collector from invoking judicial processes to collect a debt that the collector knows is time-barred. When a debt collector knows that a claim is time-barred and therefore unenforceable in bankruptcy, the filing of a proof of claim is misleading and unfair, in violation of the FDCPA.

Although the Code allows the trustee and other creditors to object to a proof of claim for a time-barred (or otherwise unenforceable) debt, the volume of bankruptcy litigation makes it inevitable that some such proofs of claim will escape detection. The deliberate filing of proofs of claim for debts known to be time-barred reflects a calculated effort to exploit the imperfections of the Code's disallowance mechanisms, and to prevent the claims-allowance process from functioning as Congress intended. Many such proofs of claim, moreover, are submitted by debt buyers who are able to purchase time-barred debts for pennies on the dollar precisely because those debts are understood to be legally unenforceable. And, contrary to petitioner's argument, the improvident allowance of proofs of claim for time-barred debt often harms the individual debtor as well as other creditors.

C. The Code does not effect an implied repeal of the FDCPA or otherwise preclude application of the Act to petitioner's conduct. To a large extent, petitioner's preclusion and implied-repeal arguments rest on the same mistaken premise—*i.e.*, that the bankruptcy laws authorize creditors to file proofs of claim for debts they know are time-barred—that underlies petitioner's contention that such practices are not "misleading" or "unfair" within the meaning of the FDCPA. Because the Bankruptcy Code and Rules

prohibit all creditors from engaging in that conduct, application of the FDCPA to debt collectors who do so would not create any conflict between the Code and the Act.

Petitioner also suggests that, even if the knowing submission of a proof of claim for a time-barred debt is properly viewed as an abuse of the bankruptcy process, the only remedies for such abuse are those established by the bankruptcy laws themselves. But the FDCPA applies by its plain terms to debt collectors' invocation of judicial processes in the course of their collection efforts, and the courts of appeals that have addressed the question have consistently held that a debt collector violates the Act if it initiates a civil suit to collect a debt it knows is time-barred. Petitioner identifies no sound reason to treat bankruptcy litigation as an exception to the general rule that a debt collector's litigation misconduct may subject it to liability under the FDCPA.

ARGUMENT

THE FDCPA PROHIBITS A DEBT COLLECTOR FROM FILING A PROOF OF CLAIM IN A BANKRUPTCY FOR A DEBT THAT THE DEBT COLLECTOR KNOWS IS TIME-BARRED

Outside bankruptcy, a creditor may be sanctioned for filing a debt-collection suit that the creditor knows is time-barred under state law. If that creditor is an FDCPA "debt collector," filing or threatening to file such a suit would violate the Act's prohibition on misleading representations and unfair practices in connection with the collection of a debt. Within bankruptcy, a creditor who files a proof of claim for a debt that the creditor knows is time-barred is similarly subject to sanctions. And when that creditor is a debt

collector, it violates the FDCPA. Nothing in the Bankruptcy Code suggests that a creditor is entitled to file a proof of claim for a debt that it knows is time-barred, and nothing in the Code precludes the application of the FDCPA to debt collectors who engage in that abusive practice.

A. The FDCPA Prohibits A Debt Collector From Filing Suit Outside Bankruptcy Seeking To Collect A Debt That The Debt Collector Knows Is Time-Barred

1. Outside bankruptcy, a plaintiff who files a suit that the plaintiff knows is time-barred is subject to sanctions for filing a frivolous suit and potentially for acting in bad faith. Federal Rule of Civil Procedure 11 requires attorneys (and unrepresented parties), *inter alia*, to certify when filing in court any "pleading, written motion, or other paper" that, "to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances," "the claims, defenses, and other legal contentions" in the filing "are warranted by existing law or by a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law." Fed. R. Civ. P. 11(b)(2). On its face, that Rule demands that a plaintiff (through counsel) must undertake a reasonable inquiry into whether any claims she plans to assert in federal court are supported by non-frivolous legal arguments.

Federal courts of appeals agree that a plaintiff violates Rule 11 if information in her hands or easily accessible to her shows that her claim is barred by an "obvious" affirmative defense. See, *e.g.*, *FDIC* v. *Calhoun*, 34 F.3d 1291, 1299 (5th Cir. 1994); *Brubaker* v. *City of Richmond*, 943 F.2d 1363, 1384-1385 (4th Cir. 1991); *White* v. *General Motors Corp.*, 908 F.2d 675,

682 (10th Cir. 1990), cert. denied, 498 U.S. 1069 (1991); see also *Tura* v. *Sherwin-Williams Co.*, 933 F.2d 1010, 1991 WL 88346, at *1 (6th Cir. 1991) (Tbl.) (unpublished); *Steinle* v. *Warren*, 765 F.2d 95, 101 (7th Cir. 1985). A plaintiff need not forbear from filing suit if she has a non-frivolous argument that a generally applicable affirmative defense would not prevail in her case, or if she needs discovery to assess the strength of a potential affirmative defense. *White*, 908 F.3d at 682; see *Calhoun*, 34 F.3d at 1299. But when the plaintiff has all the information necessary to identify a clearly meritorious affirmative defense, she can be sanctioned under Rule 11 if she files suit.[6]

Thus, while a limitations bar is generally treated as an affirmative defense that must be raised by a defendant or waived, Rule 11 requires a plaintiff to consider whether an "obvious" limitations bar applies before filing a complaint. That is so in part because a potential plaintiff typically possesses all the information needed to determine whether a limitations period has expired. Thus, while the defendant typically bears the burden of pleading a statute-of-limitations defense, "[a] pleading requirement for an answer is irrelevant to whether a complaint is well grounded in law." *Brubaker*, 943 F.2d at 1384. To treat the knowing assertion of a time-barred claim as a legitimate litigation practice would be to embrace the notion that, "because of the ignorance of one's adversary, one could advance a claim groundless in law." *Id.* at 1385.

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[6] A potential defendant can waive a statute of limitations defense. If a potential plaintiff and a potential defendant agree out of court to settle a time-barred claim through a court-enforced consent decree, the plaintiff would not violate Rule 11 by simultaneously filing a complaint and a proposed consent decree.

In the context of debt collection, the existence of a valid limitations defense is often easy for a potential plaintiff to ascertain. The owner of a debt knows (or should know) the date of the last transaction on an account (or the date of another event that would trigger the running of the limitations period) and can easily ascertain the length of the applicable statute of limitations. That is particularly so when the plaintiff is a debt buyer, which will have previously ascertained the age (and thus the likely enforceability) of a debt in deciding how high a price to pay. See pp. 2-3, *supra*. The owner of a debt is also well-positioned to assess whether there exists any non-frivolous basis (such as tolling) for avoiding an otherwise-applicable limitations bar. Under the rule applied by every court of appeals that has considered the issue, a plaintiff outside the bankruptcy context engages in sanctionable conduct when it knowingly files a time-barred debt-collection suit.

2. The FDCPA makes it unlawful for a debt collector to "use any false, deceptive, or misleading representations or means in connection with the collection of any debt," including by making a "false representation" about "the character, amount, or legal status of any debt." 15 U.S.C. 1692e(2)(A). The FDCPA also prohibits debt collectors from using "unfair or unconscionable means to collect or attempt to collect a debt." 15 U.S.C. 1692f.

When a debt collector sues or threatens to sue to collect a debt that it knows is time-barred, the debt collector violates the FDCPA. The filing of a suit, or the threat to file a suit, is an implicit representation that the plaintiff has a good-faith basis to believe that the underlying debt is legally enforceable. When a

debt collector knows that the expiration of an applicable limitations period has rendered the debt legally unenforceable, the filing of a suit or the threat to file a suit is a misrepresentation of the "character" or "legal status" of the debt. 15 U.S.C. 1692e(2)(A). Because the FDCPA prohibits representations that are "misleading" as well as statements that are "false," a debt collector's implicit representation that an unenforceable debt is enforceable can violate the FDCPA even if the debt collector does not make an explicit false statement. See *Buchanan* v. *Northland Grp., Inc.*, 776 F.3d 393, 396 (6th Cir. 2015) (Sutton, J.) (explaining that the FDCPA "outlaws more than just falsehoods"). The federal courts that have addressed the issue "have consistently held that a debt collector violates the FDCPA by filing a lawsuit or threatening to file a lawsuit to collect time-barred debt." *In re Dubois*, 834 F.3d 522, 527 (4th Cir. 2016), petition for cert. pending, No. 16-707 (filed Nov. 23, 2016); see *Crawford* v. *LVNV Funding, LLC*, 758 F.3d 1254, 1259 (11th Cir. 2014) (collecting cases), cert. denied, 135 S. Ct. 1844 (2015). As in the Rule 11 context, that is true even though the expiration of a limitations period is an affirmative defense.[7]

When a debt collector knows that a debt is not judicially enforceable, filing or threatening to file a collec-

[7] The FDCPA contains a safe harbor under which a debt collector can avoid liability "if the debt collector shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error." 15 U.S.C. 1692k(c); see generally *Jerman* v. *Carlisle, McNellie, Rini, Kramer & Ulrich, L.P.A.*, 559 U.S. 573 (2010). But when a debt collector who knows that a debt is time-barred initiates or threatens to initiate legal action, it violates the Act.

tion suit also violates the FDCPA's prohibition on using unfair means of collecting a debt. 15 U.S.C. 1692f. In most jurisdictions, a consumer's partial payment on a time-barred debt or a promise to resume payments on such a debt will restart the statute of limitations for the entire amount of the debt—a fact that most consumers are unlikely to know. 2013 FTC Report 47; see Pet. Br. 17. When faced with the threat of legal action to enforce a debt that the consumer may not know is judicially unenforceable, a consumer may offer (or be invited to offer) a small partial payment to forestall judicial action, without knowing the legal consequences of that step. A debt collector thus violates the FDCPA's prohibition on using "unfair" practices when it induces or invites a consumer to remit partial payment for an unenforceable debt by giving the consumer the false impression that the debt is legally enforceable. See *McMahon* v. *LVNV Funding, LLC*, 744 F.3d 1010, 1020 (7th Cir. 2014) (debt collector violated FDCPA by sending letter that offered to "settle" debt because that language gave the misleading impression that the debt was legally enforceable); *Ehsanuddin* v. *Wolpoff & Abramson*, No. 06-cv-708, 2007 WL 543052, at *4 (W.D. Pa. Feb. 16, 2007) ("[T]he fact that the statute of limitations defense could be waived by the unsuspecting consumer against whom a lawsuit is filed appears to present the precise situation that the FDCPA was designed to thwart.").

More generally, statutes of limitations "are not simply technicalities," *Board of Regents of the Univ.* v. *Tomanio*, 446 U.S. 478, 487 (1980), but reflect strong public-policy determinations about the unfairness of subjecting an adversary to suit after a speci-

fied period of time, *United States* v. *Kubrick*, 444 U.S. 111, 117 (1979). See *CTS Corp.* v. *Waldburger*, 134 S. Ct. 2175, 2183 (2014) ("Statutes of limitations 'promote justice by preventing surprises through * * * revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared.'") (quoting *Order of R.R. Telegraphers* v. *Railway Express Agency, Inc.*, 321 U.S 342, 348-349 (1944)). Those policy concerns have particular salience in the consumer-debt context. After the passage of many years, a consumer may not remember, or may lack the documentation needed to prove, the facts establishing a limitations defense. And "even if the consumer realizes that she can use time as a defense, she will more than likely still give in rather than fight the lawsuit because she must still expend energy and resources and subject herself to the embarrassment of going into court to present the defense." *Kimber* v. *Federal Fin. Corp.*, 668 F. Supp. 1480, 1487 (M.D. Ala. 1987). When a debt collector attempts to evade the effect of a statute of limitations with misleading partial truths, the debt collector violates the FDCPA.[8]

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[8] In its opening brief, petitioner does not address whether a debt collector violates the FDCPA by filing or threating to file suit on a debt that the plaintiff knows is time-barred. Petitioner's amicus DBA International, Inc. (DBA) is a trade association representing agencies that purchase debt on the secondary market. DBA Amicus Br. 1-2. DBA operates a certification program that certifies debt-buying companies holding approximately 80% of the purchased debt nationwide. *Id.* at 2. Petitioner is certified under that program. *Id.* at 5. Certification in the program requires certified companies to conform to the program's standards. *Id.* at 2. One of those standards governs the collection of time-barred debt and directs that a "Certified Company shall not knowingly

B. A Debt Collector Violates The FDCPA When It Files A Proof Of Claim In Bankruptcy For A Debt That It Knows Is Time-Barred

As explained above, outside bankruptcy, an attempt to use legal process to enforce a debt that a creditor knows is time-barred can trigger sanctions under Federal Rule of Civil Procedure 11, and it violates the FDCPA if the plaintiff is a "debt collector." Neither the Bankruptcy Code nor the FDCPA suggests that a different rule should apply in bankruptcy. A creditor that knowingly files a proof of claim for a time-barred debt can be sanctioned under Federal Rule of Bankruptcy Procedure 9011, the bankruptcy counterpart to Rule 11. And, as the court below correctly held, an FDCPA "debt collector" violates the Act if it engages in that conduct.

1. Nothing in the Bankruptcy Code authorizes enforcement of a time-barred claim

Petitioner argues (Br. 18-22) that a creditor has a "right" or "entitle[ment]" to file a proof of claim for a debt that the creditor has no good-faith basis to believe is judicially enforceable. Petitioner relies on the Code's statement that a creditor "may file a proof of claim," 11 U.S.C. 501(a), and on its provision of a mechanism for disallowing claims that cannot be enforced in bankruptcy, 11 U.S.C. 502(b)(1). Recognition of such a "right" would subvert the careful claim-sifting process that is critical to the proper administration of bankruptcy cases.

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bring or imply that it has the ability to bring a lawsuit on a debt that is beyond the applicable statute of limitations, even if state law revives the limitations period when a payment is received after the expiration of the statute." *Id.* at 3 (citation omitted).

a. Section 501 of the Code states that "[a] creditor * * * may file a proof of claim." 11 U.S.C. 501(a). Contrary to petitioner's argument, however, that generalized permission does not speak to the specific question whether a creditor may legitimately file a proof of claim for a debt that it knows is time-barred. "In expounding [on] a statute, [a court] must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law and to its object and policy." *Kelly* v. *Robinson*, 479 U.S. 36, 43 (1986) (quoting *Offshore Logistics, Inc.* v. *Tallentire*, 477 U.S. 207, 221 (1986)) (citations omitted). "It is a 'fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.'" *National Ass'n of Home Builders* v. *Defenders of Wildlife*, 551 U.S. 644, 666 (2007) (quoting *FDA* v. *Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000)) (citation omitted).

Section 501(a) is simply one element of the larger claim-sifting process in bankruptcy. As petitioner acknowledges (Br. 19), other Code provisions are designed to ensure that time-barred claims are *not* paid. Section 502(b) of the Code states that a claim "shall" be "allow[ed]" *unless* "such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured." 11 U.S.C. 502(b)(1). A time-barred claim is "unenforceable against the debtor and property of the debtor[] under * * * applicable law," *ibid.*, and petitioner recognizes (Br. 19) that such a claim should be "disallowed, with the result that it will not be paid by the estate." See 11 U.S.C. 558 (providing that a bank-

ruptcy "estate shall have the benefit of any defense available to the debtor * * * , including statutes of limitations"); *Owens* v. *LVNV Funding, LLC*, 832 F.3d 726, 739 (7th Cir. 2016) (Wood, C.J., dissenting) (explaining that, when the statute of limitations on a debt expires, "the bankruptcy process is one of the avenues of collection that" is "close[d] off for the creditor"), petition for cert. pending, No. 16-315 (filed Aug. 26, 2016). That approach is consistent with the bedrock bankruptcy-law principle that "[p]roperty interests are created and defined by state law," *Butner* v. *United States*, 440 U.S. 48, 55 (1979), which, *inter alia*, typically defines the period of time during which a debt will remain enforceable.

The Code thus reflects Congress's determination that, if a debt is unenforceable outside of bankruptcy, a claim for that debt should be disallowed in bankruptcy as well. Petitioner emphasizes (Br. 17-18) that it has a right to payment on its claim, even if the only available means of collection is to ask the debtor for voluntary repayment. But a proof of claim submitted in a bankruptcy case "is no mere request on moral grounds to turn money over from the bankruptcy estate to the claimant: it is a legal mechanism through which the payment of the claim can be compelled, if the claim is not disallowed by the bankruptcy court." *Owens*, 832 F.3d at 739 (Wood, C.J., dissenting). Submission of a proof of claim therefore is properly understood, not simply as a representation that the debtor is morally obligated to pay a particular sum, but as a representation that the creditor has a good-faith basis to believe that it is entitled to payment under applicable bankruptcy and non-bankruptcy law. Nothing in the Code suggests that a creditor may

legitimately submit a proof of claim that it knows is subject to disallowance under the Code.

Petitioner argues (Br. 18-19) that a claim for a time-barred debt is unenforceable in bankruptcy only when a trustee or other party in interest objects to a proof of claim. As explained above, however, federal courts have consistently held (and petitioner's opening brief does not dispute) that a plaintiff who knowingly files a time-barred suit can be sanctioned for litigation misconduct, even though the statute of limitations is an affirmative defense. See pp. 11-13, *supra*. Nothing in the Code suggests that Congress intended to be more solicitous of time-barred claims in the bankruptcy context. Rather, inside as outside bankruptcy, the propriety of invoking judicial process to enforce a debt depends on whether the creditor has a good-faith basis to believe that the debt is judicially enforceable.

b. When a creditor files a proof of claim in bankruptcy seeking to enforce a debt the creditor knows is time-barred, that filing may trigger sanctions under Federal Rule of Bankruptcy Procedure 9011. Like Federal Rule of Civil Procedure 11, Rule 9011 states that, "[b]y presenting to the court" any "paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances, * * * the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law." Fed. R. Bankr. P. 9011(b)(2). Federal Rule of Bankruptcy Procedure 3001(f) provides that "[a] proof of claim executed and filed in conformance with these rules shall constitute prima

facie evidence of the validity and amount of the claim." Fed. R. Bankr. P. 3001(f). Thus, when a creditor (or its attorney) files a proof of claim, it implicitly represents that the underlying claim is "valid[]," *ibid.*, and enforceable in bankruptcy. Such a certification is not "warranted by existing law," Fed. R. Bankr. P. 9011(b)(2), when the creditor knows that the claim is time-barred because the Code specifically provides that time-barred claims should be disallowed.

Petitioner contends (Br. 18-19) that, by providing a mechanism for objecting to and disallowing time-barred claims, the Code affirmatively "*invites* claims for time-barred debts to be brought into the bankruptcy process" even when the persons who submit them lack any good-faith basis for believing them to be timely. Br. 19 (emphasis added). That is incorrect. In bankruptcy, as in ordinary civil litigation, a limitations bar is an affirmative defense that may be waived if it is not promptly asserted. But Rule 9011 requires in bankruptcy what Rule 11 requires in other civil-litigation contexts: that parties and attorneys forbear from seeking to enforce claims that they know are time-barred. See pp. 11-13, *supra*.

Petitioner also invokes (Br. 5, 12, 20) Federal Rule of Bankruptcy Procedure 3001, which specifies the particular facts that must be included in a proof of claim for a consumer debt, including the date of the account holder's last transaction, the date of the last payment on the account, and the date the account was charged to profit and loss. Fed. R. Bankr. P. 3001(c)(3)(A). Petitioner contends (Br. 20) that, by requiring each proof of claim to include that information, which helps debtors and others to identify and object to time-barred claims, the rules "authorize the

filing of proofs of claim for time-barred debts." That is a non sequitur. The fact that the bankruptcy rules contain other protective measures, designed to reduce the likelihood that time-barred claims will be improvidently allowed, does not suggest that the deliberate filing of such claims is a legitimate bankruptcy practice.

Petitioner relies (Br. 20-21, 28) on a proposed amendment to Rule 3001 that the Advisory Committee on Bankruptcy Rules (Advisory Committee) considered and rejected in 2009. The amendment would have required creditors to affirmatively state in a proof of claim that the claim is timely under the relevant statute of limitations. As petitioner notes (Br. 20-21), the Advisory Committee instead chose to require the disclosure of information that would allow debtors and trustees to more easily ascertain whether a particular claim is time-barred. See Advisory Comm., *Meeting of March 26-27, 2009, San Diego, California, Agenda* 87 (Mar. 26-27, 2009) (*Advisory Committee Agenda*).[9]

In explaining its rejection of the proposed amendment, however, the Advisory Committee emphasized "the need for claimants to properly investigate their claims before filing proofs of claim"; noted that "Rule 9011 imposes an obligation on a claimant to undertake an inquiry reasonable under the circumstances to determine to the best of the claimant's knowledge, information, and belief that a claim is warranted by existing law and the factual contentions have evidentiary support"; and suggested that the proof-of-claim form be amended to require a declaration under pen-

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[9] http://www.uscourts.gov/sites/default/files/fr_import/BK2009-03.pdf.

alty of perjury that the information provided is correct. *Advisory Committee Agenda* 87. Although the Advisory Committee acknowledged that requiring such a declaration would "not address[] the statute of limitations issue," the Committee noted that the declaration "would impress upon the claimant the importance of ensuring the accuracy of the information provided." *Ibid.* When Congress enacted the 1978 Code, the House Report explained that Section 501 "is permissive only" and "permits filing *where some purpose would be served*." S. Rep. No. 989, 95th Cong., 2d Sess. 61 (1978) (emphasis added); H.R. Rep. No. 595, 95th Cong., 1st Sess. 351 (1977) (same). No valid bankruptcy purpose is served when a creditor invokes judicial process to attempt to collect an unenforceable debt.

2. The FDCPA's bans on misleading representations and unfair practices prohibit debt collectors from filing proofs of claim in bankruptcy on debts they know are time-barred

a. By filing a proof of claim, a debt collector implicitly represents that it has a good-faith basis to believe that the claim is enforceable in bankruptcy. That understanding is reinforced by the Code and Rule provisions that "deem[]" any underlying claim "allowed" absent an objection, 11 U.S.C. 502(a); that declare a proof of claim to be prima facie evidence of the validity of the underlying claim, Fed. R. Bankr. P. 3001(f); and that require a certification that the claim is "warranted by existing law," Fed. R. Bankr. P. 9011(b)(2). When a debt collector knows that a claim is time-barred and therefore unenforceable in bankruptcy, the filing of a proof of claim is misleading and unfair, in violation of the FDCPA. By representing

that a time-barred debt is enforceable in bankruptcy, a debt collector mischaracterizes "the character" and the "legal status" of the debt, in violation of 15 U.S.C. 1692e(2)(A).

Petitioner asserts (Br. 27-28) that its proof of claim was "accurate with regard to the 'legal status' of the debt" because it "contained all the information required by Bankruptcy Rule 3001." But the FDCPA prohibits not only false representations, but also *misleading* representations. The inclusion of both prohibitions in the same provision demonstrates that the statue bans some representations that are factually accurate but are likely to mislead the relevant audience. Such a practice is also "unfair" within the meaning of the FDCPA because a creditor that knowingly files a proof of claim for a time-barred debt seeks money that it can obtain only if the bankruptcy system fails to operate as Congress intended. A debt collector that attempts to game the system by hoping that the debtor and trustee will fail to notice or assert an ironclad affirmative defense (and by requiring a debtor or trustee to expend energy and resources to identify and assert a limitations defense that the creditor is already aware of) engages in the type of abusive conduct the FDCPA is intended to prohibit.

b. Petitioner argues (Br. 29) that, unlike the typical debt-collection communication, which is directed to an individual consumer debtor, its proof of claim was directed to respondent's attorney and the Chapter 13 trustee. While recognizing (*ibid.*) that courts generally analyze whether particular conduct violates the FDCPA's prohibition on misleading representations by asking whether an unsophisticated consumer would be misled, petitioner urges this Court to adopt a dif-

ferent "competent attorney" standard with respect to bankruptcy proofs of claim. That argument ignores the fact that many bankruptcy filers are unrepresented. But in any event, this Court need not decide whether an unsophisticated-consumer or competent-attorney standard applies to a debt collector's proof of claim. Cf. *Sheriff* v. *Gillie*, 136 S. Ct. 1594, 1602 n.6 (2016) (declining to decide whose perspective is relevant in assessing whether a representation is misleading). Filing a proof of claim constitutes an implicit representation that there is a good-faith basis to believe the claim is enforceable in bankruptcy and "is warranted by existing law." Fed. R. Bankr. P. 9011(b)(2). A debt collector's submission of a proof of claim for a debt that the creditor knows is time-barred therefore is misleading under either an unsophisticated-consumer or competent-attorney standard.

c. Petitioner argues (Br. 31-34) that knowingly filing a proof of claim for a time-barred debt is not "unfair" under the FDCPA because the Code both establishes mechanisms to oppose untimely claims and affords various other protections to debtors in bankruptcy. Petitioner also suggests (Br. 37-38) that, at least in a case (like this one) where the debtor or trustee has successfully objected to the underlying proof of claim, any FDCPA suit represents an inappropriate attempt by "plaintiffs' lawyers" to profit from "technical violations" of the Act. Those arguments lack merit.

The Code instructs that, "if a purpose would be served," the trustee should "examine proofs of claims and object to the allowance of any claim that is improper." 11 U.S.C. 704(a)(5); see Pet. Br. 29-30. Numerous courts have recognized, however, that trustees cannot realistically be expected to identify every time-

barred (or otherwise unenforceable) claim filed in every bankruptcy. See, *e.g.*, *In re Edwards*, 539 B.R. 360, 365 (Bankr. N.D. Ill. 2015) ("In districts like this with a large number of chapter 13 cases, * * * trustees typically object to claims only if they are filed after the claims bar date or improperly seek priority treatment.") (footnote omitted); see also *Owens*, 832 F.3d at 740 (Wood, C.J., dissenting); *In re Feggins*, 540 B.R. 895, 901 n.5 (Bankr. M.D. Ala. 2015), aff'd, *LVNV Funding, LLC* v. *Feggins*, No. 15-cv-893, 2016 WL 4582061 (M.D. Ala. Sept. 2, 2016). And even apart from the costs imposed when particular time-barred claims are improvidently allowed, the large-scale submission of such claims (see pp. 26-27, *infra*) diverts trustee resources from other tasks and thus hinders the administration of the bankruptcy system. A trustee's separate obligation to object to invalid claims therefore does not negate a creditor's duty to refrain from filing claims it knows are legally unenforceable.

That is particularly so because the knowing submission of a proof of claim for a time-barred debt represents a deliberate effort to exploit the imperfections of the alternative safeguards that petitioner identifies. A creditor that submits such a claim can gain a practical advantage only if the claims-allowance process fails to operate as Congress intended. A creditor that files a claim for a time-barred debt thus is "exploiting a weakness in the bankruptcy system and preying on potential error to collect debts where it should not." *In re Dubois*, 834 F.3d at 535 (Diaz, J., dissenting).

Such time-barred claims are often submitted, moreover, by companies whose business model depends on the legal unenforceability of the relevant

debts. The "business of buying stale claims and filing proofs of claim in bankruptcy to collect on them * * * appears to be a big and prosperous business." *In re Edwards*, 539 B.R. at 365. Debt buyers are able to purchase time-barred debt for pennies on the dollar precisely because all parties to that transaction know that the debt is unenforceable. And, given the low cost of acquiring such debt, the large-scale submission of proofs of claim in bankruptcy may be profitable even if most such claims are objected to and disallowed. Each knowing submission of a time-barred claim should be recognized for what it is: a deliberate effort to collect a legally unenforceable debt through an implicit misrepresentation that the debt remains enforceable. Such submissions are much more than "technical violations" (Pet. Br. 37) of the FDCPA, even in instances where a timely objection prevents the creditor from achieving its illicit aim.[10]

Petitioner also asserts that filing a proof of claim for a time-barred debt does not implicate the FDCPA's consumer-protection purposes because allowance of such a claim "will ordinarily have no effect on the debtor" (Br. 35), but instead "primarily affects the interests of other creditors" (Br. 36).[11] In

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[10] The government recently sued one of petitioner's amici, Resurgent Capital Services, L.P. (Resurgent), for abuse of process under 11 U.S.C. 105(a). The complaint alleges that, over a six-year period, Resurgent filed more than 142,000 proofs of claim for debts, some dating back to the 1980s, that it knew were time-barred and on which it collected more than $12 million. *In re Davis*, No. 14-20400-DRD13, Adv. No. 16-2018, at ¶¶ 36-37, 41 (Bankr. W.D. Mo.); see also *In re Freeman-Clay*, No. 14-41871-DRD13, Adv. No. 16-4102 (Bankr. W.D. Mo.).

[11] Amicus United States Chamber of Commerce contends (Br. 23) that the FDCPA does not apply to proofs of claim because a

many circumstances, however, allowance of a time-barred claim can harm a Chapter 13 debtor. If a Chapter 13 plan provides for 100% recovery for unsecured creditors, payment of a time-barred claim will take money directly from the debtor. If (as occurs in many Chapter 13 cases) a case is dismissed before completion of the plan, some amount of money from the portion of the debtor's disposable income that is dedicated to payments under the plan will have gone to pay the time-barred claim rather than to pay valid claims. When the bankruptcy fails, the debtor will consequently owe more on the valid claims than he would have if the invalid claim had not been included in the bankruptcy.

Even if a plan succeeds, moreover, payments made to time-barred creditors will reduce payments to any unsecured creditors whose claims are not discharged. In this case, for example, a majority of respondent's unsecured debt was more than $50,000 in student-loan obligations. Bankr. Ct. Doc. 1, at 17-18 (Dec. 7, 2012). If petitioner's claim had been allowed, any payments made on that claim would have reduced the amount of student-loan debt respondent repaid, thereby increasing the post-bankruptcy principal and interest respondent would still owe on that nondischarged debt after bankruptcy. See 11 U.S.C. 523(a)(8), 1328(a)(2). Petitioner is therefore wrong in arguing (Br. 36 n.7)

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proof of claim is an attempt to collect a debt from the bankruptcy estate and (in the amicus's view) the FDCPA "regulates attempts to collect financial obligations only from natural persons." That is incorrect. The relevant FDCPA prohibitions are not limited to communications made directly to consumers. Rather, they apply to "any * * * representation or means in connection with the collection of any debt," 15 U.S.C. 1692e, and to any "means to collect or attempt to collect any debt," 15 U.S.C. 1692f.

that respondent would not have suffered any harm if petitioner's claim had been allowed.

Equally meritless is petitioner's suggestion (Br. 31-32) that the availability of sanctions under Rule 9011 is sufficient to deter the type of behavior the FDCPA is designed to prohibit. Like its civil counterpart, Rule 9011 contains a safe haven that prohibits the imposition of sanctions if an offending paper is "withdrawn" within 21 days after a motion for sanctions is filed. Fed. R. Bankr. P. 9011(c)(1). A debt collector therefore can adopt a business model of filing multiple proofs of claim for time-barred debts, anticipating that some will be improvidently allowed and intending to withdraw the rest as soon as objections are raised, without incurring any risk of sanctions under Rule 9011.

In sum, filing a proof of claim for a debt that a debt collector knows is time-barred serves no valid bankruptcy purpose, undermines the claims-sifting process established by Congress, and violates the FDCPA. As one court of appeals judge has explained:

> At best, a debt collector who files such a claim wastes the trustee's time. At worst, the debt collector catches the trustee asleep at the switch and collects on an invalid claim to the detriment of other creditors and, in many cases, the debtor. In either case, the debt collector misleadingly represents to the debtor that it is entitled to collect through bankruptcy when it is not.

In re Dubois, 834 F.3d at 534 (Diaz, J., dissenting).

3. The Bankruptcy Code does not preclude application of the FDCPA to bankruptcy proofs of claim

Petitioner argues (Br. 38) that, "[e]ven if the FDCPA could be read to prohibit the filing of a proof of claim for an unextinguished time-barred debt, the Bankruptcy Code would preclude that application of the FDCPA." See Br. 38-45. Petitioner contends (Br. 43-45) in the same vein that Congress's enactment of the Code in 1978 effected an implied repeal of any such prohibition that the FDCPA might previously have imposed. Those arguments lack merit.

a. To a large extent, petitioner's preclusion and implied-repeal arguments rest on the same mistaken premise that underlies petitioner's contention that the knowing submission of a proof of claim for a time-barred debt is not "misleading" or "unfair" within the meaning of the FDCPA. Thus, petitioner contends that, "[i]f interpreted to prohibit filing a proof of claim for an unextinguished time-barred debt, the FDCPA would patently conflict with the Code, *which expressly authorizes that very practice*." Br. 40 (emphasis added). As explained above, the italicized language reflects a misunderstanding of the Bankruptcy Code and Rules, which prohibit all creditors from filing proofs of claim for debts they know are time-barred. See pp. 17-23, *supra*. Treating the conduct alleged in this case as an FDCPA violation therefore would not penalize petitioner for actions that the Code authorizes or encourages, or otherwise create any conflict between the Act and the Code.

b. Petitioner also suggests (Br. 40) that, even if the knowing submission of a proof of claim for a time-barred debt is properly viewed as an abuse of the bankruptcy process, the only remedies for such abuse

are those established by the bankruptcy laws themselves. Thus, petitioner argues (*ibid.*) that treating the conduct alleged here as an FDCPA violation would "substitute the FDCPA's broader remedies in place of the Code's own carefully calibrated ones and supplant the authority of bankruptcy courts to police conduct occurring within a bankruptcy proceeding." Relying on *Kokoszka* v. *Belford*, 417 U.S. 642, 651 (1974), petitioner contends that the FDCPA should not be construed to apply to the actions a debt collector takes in a bankruptcy case because "[n]othing in the text or legislative history reflects any intent to interfere with the 'delicate balance' of the bankruptcy system." Br. 41 (quoting *Kokoszka*, 417 U.S. at 651). Those arguments are misconceived.

The FDCPA prohibitions at issue here apply only to creditors that fall within the Act's definition of "debt collector." Those prohibitions govern, *inter alia*, the "representation[s]" that debt collectors may make "in connection with the collection of any debt," 15 U.S.C. 1692e, and the "means" they may use "to collect or attempt to collect any debt," 15 U.S.C. 1692f. By its plain terms, that language encompasses efforts by FDCPA debt collectors to invoke judicial processes in the course of their debt-collection efforts. See *Heintz* v. *Jenkins*, 514 U.S. 291, 294 (1995) ("To collect a debt or claim is to obtain payment or liquidation of it, either by personal solicitation or legal proceedings.") (quoting *Black's Law Dictionary* 263 (6th ed. 1990)).

Consistent with that understanding, the courts of appeals that have addressed the question have consistently held that a debt collector violates the FDCPA if it initiates a civil suit to collect a debt it

knows is time-barred. See p. 14, *supra*. That is so even though additional remedies (such as Rule 11 sanctions) for the same litigation misconduct may be available in the underlying debt-collection suit. And petitioner's opening brief does not dispute the general proposition that the FDCPA can apply to litigation-related misconduct committed by debt collectors.

Petitioner identifies no sound reason to treat bankruptcy litigation as an exception to that general rule. When a debt collector files a proof of claim in bankruptcy, it attempts "to obtain payment" of a debt by "legal proceedings." *Heintz*, 514 U.S. at 294. Petitioner's argument would logically imply that, even if a debt collector's proof of claim affirmatively misstates the facts bearing on a potential limitations (or other) defense, the FDCPA should be displaced in deference to the purportedly exclusive remedies provided by the Code and Bankruptcy Rules. Nothing in the Code suggests that Congress intended such an exception to the rules that generally govern debt collectors' conduct.

The effect of the court of appeals' decision in this case is simply to make additional remedies available when a particular type of creditor (an FDCPA debt collector) commits a type of bankruptcy abuse (the filing of a proof of claim for a debt the creditor knows is time-barred) that is forbidden to all creditors. Imposition of such additional remedies on a class of creditors that the FDCPA singles out for targeted regulation is fully consistent with the text and purposes of both the Act and the Code. And "[w]hen two statutes complement each other, it would show disregard for the congressional design to hold that Congress nonetheless intended one federal statute to preclude the

operation of the other." *POM Wonderful LLC* v. *Coca-Cola Co.*, 134 S. Ct. 2228, 2238 (2014).

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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DECEMBER 2016

No 16-348

IN THE

Supreme Court of the United States

MIDLAND FUNDING, LLC,
Petitioner,

v.

ALEIDA JOHNSON,
Respondent.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

BRIEF FOR RESURGENT CAPITAL SERVICES, L.P. AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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QUESTIONS PRESENTED

1. Whether the filing of an accurate proof of claim for an unextinguished time-barred debt in a bankruptcy proceeding violates the Fair Debt Collection Practices Act.

2. Whether the Bankruptcy Code, which governs the filing of proofs of claim in bankruptcy, precludes the application of the Fair Debt Collection Practices Act to the filing of an accurate proof of claim for an unextinguished time-barred debt.

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INTEREST OF AMICUS CURIAE[1]

Resurgent Capital Services, L.P. services debt owned by affiliated and non-affiliated entities and files proofs of claim for that debt in bankruptcy cases. Resurgent and its affiliates, like the petitioner, have been sued in numerous cases alleging that the filing of proofs of claim on account of time-barred debt violates the Fair Debt Collection Practices Act. Indeed, the opinion below addresses not only the case currently before the Court, but also another case in which Resurgent was a defendant. *See* Pet. Br. 10 n.2; Pet. App. 1a. Moreover, an affiliate of Resurgent's is the respondent in a petition presenting the same question as that presented here, and that this Court is presumably holding pending the resolution of this case. *See Owens* v. *LVNV Funding, LLC*, No. 16-315.

SUMMARY OF ARGUMENT

The Fair Debt Collection Practices Act (FDCPA) is a consumer protection statute whose manifest purpose is to protect individual borrowers. Its text and legislative history make clear that, although the statute offers broad protection from unfair debt practices, including to certain third parties in addition to consumer borrowers themselves, all of those protections are ultimately directed at benefiting and protecting consumer borrowers.

A proof of claim in bankruptcy, however, is directed to an entirely different entity—the bankruptcy estate—which is essentially a trust operated for the

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[1] No counsel for a party authored this brief in whole or in part. No party or its counsel made a monetary contribution intended to fund the preparation or submission of this brief. The parties have filed blanket consent to the filing of amicus briefs.

benefit of creditors, and in which the debtor typically lacks any economic interest. Indeed, a principal purpose of the Bankruptcy Code is to *separate* the rights and interests of the debtor from those of the bankruptcy estate. To the extent that the allowance of a proof of claim for a time-barred debt causes an injury, that injury is borne by other creditors who risk receiving a diluted recovery on their claims against the estate—not by the debtor.

That is why the FDCPA has no application to the filing of proofs of claim. Under the Bankruptcy Code, an allowed proof of claim entitles a creditor to recover only from the bankruptcy estate, a legal entity that is comprised of certain property of the debtor but is separate and distinct from the consumer debtor. The estate is administered by a trustee—a bankruptcy professional appointed by the Office of the United States Trustee—who oversees the collection and distribution of estate property to creditors. The Code assigns to the trustee, not the consumer debtor, the duty to object to proofs of claim as to which there may be a valid defense. And it clearly considers statutes-of-limitations defenses to be defenses of the estate, not the consumer. The filing of a proof of claim has little to do, as a legal matter, with the consumer—and nothing to do with the FDCPA.

The allowance of a claim against an individual debtor's estate virtually never has any economic effect on the debtor. The vast majority of consumer (*i.e.*, individual) debtors seek relief under either chapter 7 or chapter 13 of the Bankruptcy Code. In both chapter 7 and chapter 13 cases, upon completion of the bankruptcy process, the consumer debtor will receive a discharge of certain prepetition debts. In chapter 7, a debtor must relinquish all of his or her nonexempt,

prepetition property to pay prepetition claims. It is exceedingly rare for anything to be left over to be distributed to the debtor, who is entitled to receive any remaining property only after prepetition creditors are paid in full. And in chapter 13 cases, the debtor is typically required to dedicate all of his or her projected disposable income over a three to five year period to paying prepetition claims—regardless of the magnitude of the claims against the estate. In either case, the total dollar value of allowed claims affects only the relative distributions of value among creditors and does not affect the debtor's obligations.

Some courts have concluded that filing a factually accurate complaint asserting a time-barred state-law collection action violates the FDCPA on the ground that the initiation of legal process against an unsophisticated consumer is inherently abusive. Even if that were correct, however, the principle has no application to the filing of a proof of claim, which has no effect on an individual debtor, and runs only against a bankruptcy estate that is represented by a court-appointed trustee with sophisticated counsel.

Finally, even if one were to read the FDCPA to create a cause of action for filing a proof of claim for a debt that is subject to a valid statute-of-limitations defense, both the Bankruptcy Code and the FDCPA would require that such a cause of action be pursued by the bankruptcy estate, not the individual debtor—thus underscoring that the FDCPA should not be construed to give rise to such a cause of action in the first place, as it would do nothing to advance the statute's consumer-focused purpose.

ARGUMENT

I. THE PROTECTIONS OF THE FDCPA ARE DIRECTED TO CONSUMERS

"The FDCPA is a consumer protection statute that prohibits certain abusive, deceptive, and unfair debt collection practices." *Marx* v. *General Revenue Corp.*, 133 S. Ct. 1166, 1171 n.1 (2013). Importantly, the statute prohibits such practices only to the extent they affect "consumers and those who have a special relationship with the consumer … such that the Act is still protecting the consumer." *O'Rourke* v. *Palisades Acquisition XVI, LLC*, 635 F.3d 938, 943 (7th Cir. 2011).

The statute's focus on consumers is reflected across its text and legislative history. They make clear that, consistent with Congress's purpose in enacting the law, the FDCPA prohibits only activities that burden or injure consumers.

First, the FDCPA's focus on consumers appears in the statute's definitional provisions. As the Petitioner's Brief explains (at 26-34), the statute prohibits the making of "false, deceptive, or misleading representation … in connection with the collection of any debt," 15 U.S.C. § 1692e, and the use of "unfair or unconscionable means to collect or attempt to collect any debt," *id.* § 1692f.

In the FDCPA, however, the word "debt" is a term of art with a far narrower meaning than its ordinary English meaning of money that is owed. Rather, under the FDCPA, "debt" is defined as "any obligation or alleged obligation *of a consumer* to pay money arising out of a transaction in which the [goods or services] which are the subject of the transaction are primarily for personal, family, or household purposes." 15 U.S.C. § 1692a (emphasis added). And the FDCPA defines "'consumer' [as] any *natural person* obligated or alleg-

edly obligated to pay any debt." *Id.* § 1692a(3) (emphasis added).

Second, the FDCPA's self-proclaimed purpose is "to protect consumers." 15 U.S.C. § 1692(b), (e). The statute explains that "[a]busive debt collection practices contribute to the number of personal bankruptcies, to marital instability, to the loss of jobs, and to invasions of individual privacy"—problems suffered only by consumers and other closely related natural persons. *Id.* § 1692(a).

The legislative history similarly declares that the FDCPA's "purpose is to protect *consumers* from a host of unfair, harassing, and deceptive debt collection practices without imposing unnecessary restrictions on ethical debt collectors." S. Rep. No. 95-382, at 1-2 (1977) (emphasis added). It further clarifies that "the [statute] applies only to debts contracted by *consumers* for personal, family, or household purposes; it has no application to the collection of commercial accounts." *Id.* at 3 (emphasis added).

Third, the FDCPA's prohibitions address paradigmatic *consumer*-targeting harassment. For example, the statute prohibits "[c]ausing a telephone to ring or engaging any person in telephone conversation repeatedly or continuously with intent to annoy, abuse, or harass." 15 U.S.C. § 1692d(5). It forbids "[t]he use or threat of use of violence or other criminal means to harm the physical person." *Id.* § 1692d(1). And it bans various "false representation[s] or implication[s]," such as "that the debt collector is vouched for, bonded by, or affiliated with the United States or any State" or "is an attorney," or that "documents are legal process." *Id.* § 1692e(1), (3), (13).

In enacting the FDCPA, Congress found that those specific problems beset consumers—typically consumers who were commercially unsophisticated and with limited means to protect their legal interests. The legislative history explains that the "increasing incidence of debt collectors abusing consumers by using various means of harassment and deception" gave rise to the "[n]eed for [the] [l]egislation":

> Consumers are frequently sent phony legal documents. They are harassed by phone at home and at work. Debt collectors impersonate attorneys and policemen. If these tactics do not work, threats of bodily harm or death are sometimes made.... [T]hese debt collection tactics affect the lives of many consumers throughout the country.... Yet, at present there is no effective regulation of debt collectors.... [T]he facts of frequent consumer abuse and inadequate Federal and State regulation of debt collection practices make this legislation necessary and appropriate.

H.R. Rep. No. 95-131, at 2-4 (1977).

While the FDCPA allows nonconsumers to sue to enforce its provisions in certain situations, *see Wright* v. *Finance Serv. of Norwalk, Inc.*, 22 F.3d 647, 649 & n.1 (6th Cir. 1994); *see also* 15 U.S.C. § 1692k(a) ("Except as otherwise provided by this section, any debt collector who fails to comply with any provision of this subchapter with respect to any person is liable to such person."), it does so only in the service of its core purpose of protecting consumers, *see O'Rourke*, 635 F.3d at 943.

For example, Congress determined that a debt collector should be liable when it harasses "the family,

employer and neighbors of the consumer." H.R. Rep. No. 95-131, at 8. In doing so, Congress rightly noted that such people are often targeted for harassment because of their close relationship to the consumer. *Id.* And it also explained how protecting these third parties operates to protect consumers. The House Report points out that "a debt collector's contact with a consumer's employer" can "constitute[] an unwarranted invasion of the consumer's privacy and interference with the consumer's employee-employer relationship." *Id.* at 5. The Senate Report echoes this statement, observing that "contact [with] third persons such as a consumer's friends, neighbors, relatives, or employer" can "result in serious invasions of privacy, as well as the loss of jobs." S. Rep. No. 95-382, at 4.

At bottom, then, the FDCPA seeks to protect against "the type of actions that would intimidate unsophisticated individuals and which … would likely disrupt a debtor's life." *Guerrero* v. *RJM Acquisitions LLC*, 499 F.3d 926, 938 (9th Cir. 2007). This context must guide interpretation of the statute. *Regions Hosp.* v. *Shalala*, 522 U.S. 448, 460 & n.5 (1998); *U.S. Nat'l Bank of Or.* v. *Independent Ins. Agents of Am., Inc.*, 508 U.S. 439, 455 (1993).

II. THE FILING OF A PROOF OF CLAIM AGAINST A BANKRUPTCY ESTATE DOES NOT HARM AN INDIVIDUAL DEBTOR

Unlike the practices at which the FDCPA was aimed, the filing of a proof of claim in bankruptcy does not harm any individual consumer debtor. In either a chapter 7 or a chapter 13 bankruptcy, a creditor files a proof of claim against the bankruptcy estate—an entity distinct from the debtor that is represented by sophisticated bankruptcy professionals. And in the typical

case, whether a proof of claim is allowed or disallowed has no effect at all on the debtor. The claims allowance process in bankruptcy simply falls outside the ambit of the FDCPA.

A. A Proof of Claim Does Not Run Against The Debtor—It Runs Against The Bankruptcy Estate

Proofs of claim are "file[d] … against the [bankruptcy] estate." *Travelers Cas. & Sur. Co. of Am.* v. *Pacific Gas & Elec. Co.*, 549 U.S. 443, 449 (2007); *see also* 4 *Collier on Bankruptcy* ¶ 501.01[2][a] (16th ed. 2016) (filing a proof of claim reflects "a claim on the assets of the bankruptcy estate").

The estate is a legal entity—wholly distinct from the debtor—that comes into being upon the filing of a bankruptcy petition. 11 U.S.C. § 541(a); *see also United States* v. *Mitchell*, 476 F.3d 539, 544 (8th Cir. 2007) ("The filing of a bankruptcy petition creates a new legal entity: the bankruptcy estate.").

The Bankruptcy Code sets out the property that comes into the bankruptcy estate: "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). The bankruptcy estate is administered by a trustee—a bankruptcy professional appointed by the Office of the United States Trustee[2]—who oversees the collection

[2] The Office of the United States Trustee has appointed between one and five "standing" chapter 13 trustees in each federal judicial district who serve as trustees in chapter 13 cases in their respective districts. In chapter 7 cases, the trustee is assigned from a list of chapter 7 "panel" trustees appointed by the Office of the United States Trustee. *See* U.S. Dep't of Justice, *Private Trustee Information*, https://www.justice.gov/ust/private-trustee-information (updated May 12, 2015).

and liquidation of that property and its distribution to creditors with allowed claims. 11 U.S.C. §§ 321-323, 701-705, 1302; *see also* H.R. Rep. No. 95-595, at 91-92 (1977).

The debtor stands separate and apart from the estate; they "are distinct entities in an individual's bankruptcy proceeding." *Katz* v. *C.I.R.*, 335 F.3d 1121, 1127 (10th Cir. 2003); *see also*, *e.g.*, *In re Smith*, 235 F.3d 472, 477-478 (9th Cir. 2000) ("The Bankruptcy Code distinguishes between property of the estate in bankruptcy and property of the debtor."). As Congress has recognized, the long-standing "premise" underlying bankruptcy law is "that the money of the estate [i]s essentially a trust for the benefit of the bankrupt's *creditors*." H.R. Rep. No. 95-595, at 91 (emphasis added).

Once a bankruptcy petition is filed, an automatic stay takes effect, barring creditors from attempting to "exercise control over property of the estate," 11 U.S.C. § 362(a)(3), or attempting to enforce or collect prepetition claims against the debtor or the estate, *see id.* § 362(a) (separately addressing the automatic stay protections enjoyed by "property of the estate" and "property of the debtor"). The automatic stay ensures both that the trustee can marshal and distribute the debtor's assets without disruption and that creditors need not compete in a "race to the courthouse" to enforce their claims.

While the Bankruptcy Code thus halts any collection activity against *the debtor* during the pendency of the bankruptcy case, it permits creditors to seek recovery on their prepetition claims from *the bankruptcy estate*. Creditors who wish to receive a distribution from the estate must file a proof of claim, which is generally "deemed allowed" unless a party in interest objects. 11

U.S.C. §§ 501, 502. If a party in interest objects, the bankruptcy court determines whether the claim should be allowed, generally by applying nonbankruptcy law. *See id.* § 502(b). Where a proper objection is filed to a proof of claim for a debt whose collection is barred by the statute of limitations under applicable state law, the proof of claim would be disallowed. *Id.* § 502(b)(1).

The Code assigns to the trustee—not to the debtor—the duty to "examine proofs of claims and object to the allowance of any claim that is improper." 11 U.S.C. § 704(a)(5); *see also id.* § 1302(b)(1) (incorporating this duty by cross-reference). And it provides that "[t]he estate shall have the benefit" of any defense to any claim that would be available to the debtor under nonbankruptcy law, including "statutes of limitation[s]." *Id.* § 558; *see also* 5 *Collier on Bankruptcy* ¶ 558.01 (defenses otherwise belonging to the consumer "inure to the benefit of the estate"). Moreover, "[a] waiver of any such defense by the debtor after the commencement of the case does not bind the estate." 11 U.S.C. § 558.

In sum, in contrast to a collection action directed against an unsophisticated consumer, a proof of claim is directed against an estate represented by a sophisticated trustee and its counsel.

B. The Allowance Of A Claim Almost Always Has No Economic Effect On The Debtor

In the vast majority of consumer bankruptcy cases, whether a proof of claim is allowed or disallowed affects only the distribution among creditors and will have no effect on the debtor. Indeed, as a matter of bankruptcy law, a consumer debtor rarely even has standing to object to the allowance of a claim. That is because the

debtor typically has no "pecuniary interest" in the proceedings: "[N]o matter how the estate's assets are disbursed by the trustee, no assets will revert to the debtor." *In re Cult Awareness Network, Inc.*, 151 F.3d 605, 607 (7th Cir. 1998).

1. *Chapter 7*. "Chapter 7 … gives an insolvent debtor the opportunity to discharge his debts by liquidating his assets to pay his creditors." *Law* v. *Siegel*, 134 S. Ct. 1188, 1192 (2014). In a chapter 7 bankruptcy, the filing of the petition creates the estate, 11 U.S.C. § 541(a)(1), and triggers appointment of the trustee, *id.* § 701, whose duties include "collect[ing] and reduc[ing] to money the property of the estate," *id.* § 704(a)(1), distributing the proceeds to creditors, *id.* § 726.

In a chapter 7 case, the estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). An individual debtor may exempt certain assets—*e.g.*, a certain amount of equity in a residence or a vehicle—from the estate and thus from creditor claims. *Id.* § 522. If there is any nonexempt estate property unencumbered by a lien—in most chapter 7 cases, there is none—the chapter 7 trustee sells that property and distributes the proceeds according to creditors' statutory priority. The total size of the estate—the total value available for distribution to creditors—is in no way dependent upon the number and dollar amount of proofs of claim filed against the estate. Rather, the total value of allowed claims against the bankruptcy estate affects only the percentage payment that creditors receive. In other words, the consequence of allowance of any given proof of claim is that it dilutes the recoveries of other creditors holding allowed claims—it makes no difference at all to the debtor.

In return for surrendering nonexempt prepetition assets for distribution to creditors, the chapter 7 debtor may receive a discharge of certain prepetition debt, meaning that, after the bankruptcy, those creditors can no longer pursue the debtor for payment on their claims. 11 U.S.C. §§ 524, 727; *see Law*, 134 S. Ct. at 1192.[3] The discharge "operates as an injunction against the commencement or continuation of an action … to collect … any such debt as a personal liability of the debtor." 11 U.S.C. § 524(a)(2). Most importantly, it applies whether or not the creditor has received any distribution from the estate on its claim. *Id.* §§ 524, 727; *see also Law*, 134 S. Ct. at 1192.

Because the property that the debtor must surrender to the estate does not depend on the dollar amount of allowed claims against the estate, and because the debtor's entitlement to a discharge does not depend on the amount creditors receive in the bankruptcy, allowance or disallowance of any given claim is—except in the extremely rare case—irrelevant from the chapter 7 debtor's perspective. It affects only the recoveries amongst creditors.

It is true that, if all creditors have been paid in full from the estate, the debtor is entitled to the remainder. 11 U.S.C. § 726(a)(6). But this situation is the "limited and rare exception" to the normal course of events. *In re Tuttle*, 259 B.R. 735, 739 (Bankr. D. Kan. 2000); *see also Cult Awareness Network*, 151 F.3d at 607 ("Debtors, particularly Chapter 7 debtors, rarely have … a pecuniary interest [in a bankruptcy order] because no matter how the estate's assets are disbursed by the trustee, no assets will revert to the debtor."). Indeed,

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[3] Discharge may be denied for certain misconduct, 11 U.S.C. § 727(a), and certain debts are non-dischargeable, *id.* § 523(a).

the vast majority of chapter 7 cases are so-called "no asset" cases: After subtracting the assets they are entitled to exempt from the estate under section 522, individual chapter 7 debtors typically have no property that is unencumbered by a lien remaining for *any* distribution to unsecured creditors, let alone property sufficient to pay all creditors *in full* and provide a surplus to the debtor.[4]

2. *Chapter 13*. In a chapter 13 case, the debtor proposes a plan to pay creditors with future income rather than liquidation of existing assets, as would occur in chapter 7. Eligible debtors with a regular income may retain their prebankruptcy assets, propose a plan to repay prepetition creditors over time from their future income over a fixed period of three or five years, and receive a discharge of certain prepetition debts upon completion of the repayment plan. *Hamilton* v. *Lanning*, 560 U.S. 505, 508 (2010); *see also* 11 U.S.C. § 1328 (discharge under chapter 13).

In a chapter 13 case, therefore, the bankruptcy estate is comprised not only of the debtor's interests in property "as of the commencement of the case," 11 U.S.C. § 541(a)(1), but also "earnings from services performed by the debtor after the commencement of the

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[4] *See Colonial Sur. Co.* v. *Weizman*, 564 F.3d 526, 531 (1st Cir. 2009) ("'Most chapter 7 cases involving individual debtors are no asset cases.'" (quoting Administrative Office of the United States Courts, *Chapter 7—Bankruptcy Basics*, http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter7.aspx (last visited Nov. 21, 2016))); Flynn, *Chapter 7 Asset Cases and Trustee Compensation*, 33 Am. Bankr. Inst. J. 48, 48 tbl. 1 (June 2014) (between 2006 and 2011, only 7.9% of chapter 7 cases were closed as asset cases); Lupica, *The Consumer Bankruptcy Fee Study: Final Report*, 20 Am. Bankr. Inst. L. Rev. 17, 68 (2012) (finding that 89.4% of chapter 7 cases filed after the 2005 Bankruptcy Code amendments were no-asset cases).

case, but before the case is closed, dismissed, or converted to a case under chapter 7, 11 or 12 of this title, whichever occurs first," *id.* § 1306(a).

Moreover, unlike in chapter 7, the consumer "remain[s] in possession of all property of the estate" during the bankruptcy case unless a confirmed plan provides otherwise. 11 U.S.C. § 1306(b). Consequently, the role of the trustee in a chapter 13 case is different than in a chapter 7 bankruptcy. *See id.* § 1302. The chapter 13 trustee generally does not take possession of and liquidate the debtor's property to make distributions to creditors. Rather, the debtor is charged with the rights and duties of a trustee with respect to the property of the estate in his possession. *Id.* § 1303; *see also* 8 *Collier on Bankruptcy* ¶ 1300.22[1].

Despite these distinctions, the consumer debtor is typically just as indifferent to the allowance or disallowance of proofs of claim in chapter 13 as in chapter 7. That is because a chapter 13 debtor typically dedicates all of his or her projected disposable income for the plan period to the plan, regardless of the magnitude of the claims against the estate.

Promptly after the petition date, a chapter 13 debtor is required to file a proposed plan for repayment of creditors over a three or five-year period. 11 U.S.C. § 1321; Fed. R. Bankr. P. 3015(b). "If an unsecured creditor or the bankruptcy trustee objects to [plan] confirmation, § 1325(b)(1) requires the debtor either to pay unsecured creditors in full or to pay all 'projected disposable income' to be received by the debtor over the duration of the plan." *Hamilton*, 560 U.S. at 508-509; *see also* 11 U.S.C. § 1325(b)(1).

Because the debtor typically lacks the financial means to pay all claims in full, the requirements of sec-

tion 1325(b)(1) usually force the debtor to commit to pay all of his or her disposable income during the repayment period to secure plan confirmation. Thus, in chapter 13, as in chapter 7, the debtor is generally unaffected by a creditor's filing of a proof of claim: The only consequence of the allowance of a claim as to which there might have been a valid objection is that other creditors' recovery is diluted. *See In re LaGrone*, 2015 WL 2330314, at *3 (Bankr. N.D. Ill. May 14, 2015) ("In most Chapter 13 cases, … the debtor is proposing to pay all general unsecured claims less than in full from a limited contribution. Payment of an additional unsecured claim … simply reduces the amount paid to other unsecured creditors; it does not cause the debtor to pay more into the plan."); *see also* 8 *Collier on Bankruptcy* ¶ 1325.11.

Indeed, if anything, a chapter 13 debtor benefits from the filing of a proof of claim for debt that is subject to a statute-of-limitations defense. This is so because the chapter 13 discharge extends only to "unsecured debts provided for by the plan or disallowed under section 502 of this title." 11 U.S.C. § 1328(c). Accordingly, in the absence of the filing of a proof of claim, the holder of a claim subject to a statute-of-limitations defense would—except for the unusual case in which the debt is included on the debtor's schedules—be permitted after the bankruptcy to engage in collection activity, as state law typically allows (*see* Pet. Br. 17-18 & n.3). The filing of a proof of claim renders that debt dischargeable in a chapter 13 bankruptcy, and thus subject to the discharge injunction, which bars the type of collection activity otherwise permitted by state law for debt that is subject to a valid statute-of-limitations defense.

*   *   *

Congress's manifest purpose in enacting the FDCPA was to protect individual consumers from debt collection practices that it considered abusive or misleading. The filing of a proof of claim is an act to collect from a bankruptcy estate—not from any individual consumer. The claim's allowance or disallowance is typically a matter of complete indifference to the individual debtor—the affected parties are other *creditors*, whose interests are protected by a court-appointed trustee. The claims-allowance process in bankruptcy therefore falls entirely outside of the purposes for which the FDCPA was enacted, and outside the cause of action the FDCPA creates for the benefit of consumers.

III. If The FDCPA Were To Create A Cause Of Action, It Would Belong To The Estate, Not The Debtor

Under both settled principles of bankruptcy law and the language of the FDCPA, if the Court were to conclude that the filing of an accurate proof of claim for debt that is subject to a valid statute-of-limitations defense were actionable under the FDCPA, the cause of action would belong to, and could only be asserted by, the bankruptcy estate, not the individual debtor. Indeed, a debtor would lack Article III standing to assert such a claim because there is no injury to any legally protected interest of the *debtor*. More fundamentally, the point illustrates that the FDCPA should not be construed to provide a cause of action here. *See U.S. Nat'l Bank of Or.*, 508 U.S. at 455 ("'[i]n expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy'" (alteration in original)); *see also Ransom* v. *FIA Card Servs., N.A.*,

562 U.S. 61, 71 (2011); *Kasten* v. *Saint-Gobain Performance Plastics Corp.*, 563 U.S. 1, 7 (2011).

A. As A Matter Of Bankruptcy Law, Any Cause Of Action Under The FDCPA Could Be Asserted Only By The Estate, And Not By The Debtor

Bankruptcy law makes clear that causes of action seeking redress for an injury to the bankruptcy estate may be brought only by the trustee for the benefit of the bankruptcy estate—not by an individual debtor for his or her own benefit.

Section 541 of the Bankruptcy Code makes clear that claims belonging to the debtor that arise before the petition date become property of the estate, and thus cannot be pursued by individual debtors. For example, in *Auday* v. *Wet Seal Retail, Inc.*, 698 F.3d 902 (6th Cir. 2012), the Sixth Circuit held that an individual debtor lacked standing to pursue an employment discrimination claim arising out of her termination four days before her bankruptcy filing.[5] Upon the bankruptcy filing, that claim became property of the bankruptcy estate, to be pursued (or not) by the trustee for the benefit of the estate. "[A]bsent abandonment, only the Trustee may bring the age-discrimination claim, and [the debtor] has no standing to pursue it alone." *Id.* at 904.

[5] While many of the cases discussed in text use the term "standing," as this Court explained in *Lexmark International, Inc.* v. *Static Control Components, Inc.*, 134 S. Ct. 1377 (2014), the question whether a particular litigant falls within the zone of interests protected by a particular statute is best understood as raising a traditional question of statutory construction rather than an issue of "prudential standing."

The same principle applies to claims arising out of postpetition actions that are directed at the bankruptcy estate, rather than the debtor personally. For instance, the Ninth Circuit has held that an individual debtor did not have standing to bring a claim against a bank for having frozen the debtor's bank account, allegedly in violation of the automatic stay, when the account was property of the estate, rather than the individual debtor's property. *In re Mwangi*, 764 F.3d 1168, 1174 (9th Cir. 2014); *see also In re Cook*, 520 F. App'x 697, 701 (10th Cir. 2013) ("'In the context of bankruptcy proceedings, it is well understood that a trustee, as the representative of the bankruptcy estate, is the real party in interest, and is the only party with standing to prosecute causes of action belonging to the estate once the bankruptcy petition has been filed.'"); *Moses* v. *Howard Univ. Hosp.*, 606 F.3d 789, 795 (D.C. Cir. 2010) (same).[6]

The same is true here. As explained above, to the extent that the allowance of a proof of claim for a time-barred debt causes any injury, that injury is borne by the bankruptcy estate (and, indirectly, by other creditors), not the individual debtor. It therefore follows that if the FDCPA were construed to create a cause of action arising out of such conduct, bankruptcy law would grant that cause of action to the estate rather than to the debtor.

[6] The chapter 13 plan that was confirmed in this case makes clear that estate property remains property of the bankruptcy estate throughout the plan's repayment period, and does not revest in the individual debtor until "discharge or dismissal of the case." JA9; Chapter 13 Plan ¶13(b), *In re Johnson*, No. 14-00917 (Bankr. S.D. Ala.), Dkt. 2.

B. The FDCPA Similarly Bars An Individual Debtor From Suing To Recover On Account Of An Injury To A Bankruptcy Estate

Consistent with ordinary principles of standing, the FDCPA itself likewise operates to preclude an individual debtor from bringing suit on account of collection activity that is directed against a bankruptcy estate. The provision of the FDCPA creating a private right of action provides that a debt collector who fails to comply with the statute "with respect to any person is liable to such person" for damages as set forth in the statute. 15 U.S.C. § 1692k(a).

The work done by this language is clear: Liability under the statute runs only to the "person" "with respect to [whom]" the debt collector failed to comply with the statute. Even assuming that entities other than natural persons (such as bankruptcy estates) are "persons" entitled to protection under the FDCPA, *see Anarion Investments LLC* v. *Carrington Mortgage Servs.*, 794 F.3d 568 (6th Cir. 2015) (so holding),[7] the statute grants a right of action only to the "person" who is the target of the allegedly improper debt-collection activity. Because a bankruptcy estate, not an individual debtor, is the "person" against which a proof of claim is filed, the statute does not give rise to a cause of action by the debtor arising out of that filing.

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[7] Notably, Judge Donald, one of the few courts of appeals judges to have served as a bankruptcy judge, dissented from the Sixth Circuit's conclusion that entities other than natural persons are protected by the FDCPA. *Anarion*, 794 F.3d at 571 (Donald, J., dissenting).

CONCLUSION

For the foregoing reasons, as well as those set forth in the Petitioner's Brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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NOVEMBER 2016

No. 16-348

IN THE

Supreme Court of the United States

MIDLAND FUNDING, LLC,

Petitioner,

v.

ALEIDA JOHNSON,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF OF *AMICUS CURIAE* G. ERIC BRUNSTAD, JR. IN SUPPORT OF RESPONDENT

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INTEREST OF THE *AMICUS CURIAE*[1]

The undersigned *amicus curiae* is a Senior Research Scholar in Law at the Yale Law School, has served as an Adjunct Professor of Law at the Georgetown University Law Center and the New York University School of Law, and is a frequent Visiting Lecturer in Law at the Yale Law School. He has also taught at the Harvard Law School. Among other subjects, he teaches courses on bankruptcy law, domestic and international business reorganizations, commercial transactions, secured transactions, and the federal courts. In addition to his teaching, the undersigned is a contributing author of Collier on Bankruptcy, responsible for writing several chapters of the Treatise. He is also a partner at the law firm of Dechert LLP; a prior Chair of the ABA Business Bankruptcy Committee; a former member of the Judicial Conference Advisory Committee on the Federal Bankruptcy Rules; and a Fellow of the American College of Bankruptcy.

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[1] No counsel for any party has authored this brief in whole or in part, and no party or counsel for a party has made a monetary contribution to the preparation or submission of this brief. *See* Sup. Ct. R. 37.6. Both Petitioner and Respondent have filed with the Court letters consenting to the filing of *amicus curiae* briefs in support of either or neither party.

The undersigned has briefed and argued numerous bankruptcy matters before the Court, including *Schwab v. Reilly*, 560 U.S. 770 (2010); *Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229 (2010); *Florida Dep't of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33 (2008); *Travelers Cas. & Sur. Co. v. Pacific Gas & Elec. Co.*, 549 U.S. 443 (2007); *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007); *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004); and *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000). He has otherwise participated as counsel for one of the parties in numerous other bankruptcy matters before the Court, including *Executive Benefits Insurance Agency v. Arkison*, 134 S. Ct. 2165 (2014); *Stern v. Marshall*, 131 S. Ct. 2594 (2011); *Hamilton v. Lanning*, 560 U.S. 505 (2010); *Central Virginia Cmty. College v. Katz*, 546 U.S. 356 (2006); *Rousey v. Jacoway*, 544 U.S. 320 (2005); *Kontrick v. Ryan*, 540 U.S. 443 (2004); *Lamie v. United States Trustee*, 540 U.S. 526 (2004); *FCC v. NextWave Personal Commc'ns Inc.*, 537 U.S. 293 (2003); and *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249 (1992). In addition, he has prepared and filed with the Court several amicus briefs in bankruptcy cases, including *Husky International Electronics, Inc. v. Ritz*, 136 S. Ct. 1581 (2016); *Bullard v. Blue Hills Bank*, 135 S. Ct. 1686 (2015); *Harris v. Viegelahn*, 135 S. Ct. 1829 (2015); *Wellness International Network, Ltd. v. Sharif*, 135 S. Ct. 1932 (2015); *Clark v.*

Rameker, 134 S. Ct. 2242 (2014); *Law v. Siegel*, 134 S. Ct. 1188 (2014); *Bullock v. BankCham-paign, N.A.*, 133 S. Ct. 1754 (2013); *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065 (2012); *Hall v. United States*, 132 S. Ct. 1882 (2012); *Ransom v. FIA Card Servs.*, 131 S. Ct. 716 (2011); *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260 (2010); *Howard Delivery Serv., Inc. v. Zurich American Ins. Co.*, 547 U.S. 651 (2006); *Tennessee Student Assis-tance Corp. v. Hood*, 541 U.S. 440 (2004); *Archer v. Warner*, 538 U.S. 314 (2003); and *Things Re-membered, Inc. v. Petrarca*, 516 U.S. 124 (1995).

The purpose of this brief is to address matters that bear on this Court's determination of two important issues that affect the protections af-forded to debtors in bankruptcy from fraudulent and exploitative conduct: (1) whether a creditor who qualifies as a "debt collector" under the Fair Debt Collection Practices Act ("FDCPA") violates that Act by knowingly and intentionally filing a proof of claim in bankruptcy on a time-barred debt; and (2) if such conduct does fall within the scope of the FDCPA, whether Congress clearly and manifestly intended the Bankruptcy Code to preclude application of the FDCPA to the filing of proofs of claim.

As to the first issue, the knowing and inten-tional filing of a proof of claim on a time-barred debt is a violation of the FDCPA. As the Elev-

enth Circuit noted in *Crawford v. LVNV Funding, LLC*, 758 F.3d 1254 (11th Cir. 2014), *cert. denied*, 135 S. Ct. 1844 (2015), consumer debt buyers like petitioner in this case have filed a "deluge" of stale proofs of claim in consumer bankruptcy cases in the hope of collecting on some percentage of them. The filing of these stale claims represent attempts by debt collectors to mislead debtors into the belief that the relevant debts are legally valid when the collectors know they are unenforceable. In addition, they represent illicit efforts to play off of the presumptive good faith of most creditors who file legitimate proofs of claim on enforceable obligations. As this brief explains, courts have widely held that lawsuits seeking to enforce stale claims violate the FDCPA when the creditors know the claims are unenforceable, and proofs of claim filed on the same stale debts are fundamentally no different.

On the second issue, this brief further explains that the plain language of the FDCPA makes clear that it applies to proofs of claim, and nothing in the Bankruptcy Code makes an exception to the FDCPA in this context. This Court has made clear that it will not construe a statute as being implicitly repealed by a later statute unless Congress's intent to do so is "clear and manifest." This high burden cannot be met in this instance.

STATEMENT

Petitioner Midland Funding, LLC ("Midland") is in the business of purchasing and seeking to collect unpaid debts. Pet. App. 3a. Midland purchased a debt that Respondent Aleida Johnson ("Johnson") at one point owed to Fingerhut Credit Advantage. *Id.* The date of the last transaction on Johnson's account with Fingerhut was in May of 2003. *Id.*

Johnson filed a Chapter 13 bankruptcy petition in March of 2014. *Id.* In May of 2014, Midland filed a proof of claim in Johnson's bankruptcy case, seeking to collect $1,879.71 on the debt purchased from Fingerhut. *Id.* Midland's claim is governed by Alabama law, which imposes a six-year statute of limitations on claims to collect on an overdue debt, and therefore under Alabama law the claim is time-barred. *Id.*

Johnson commenced an action against Midland in the United States District Court for the District of Alabama, alleging that Midland's time-barred attempt to collect on the overdue debt was a violation of the Fair Debt Collection Practices Act ("FDCPA"). Pet. App. 18a-19a. The FDCPA prohibits a "debt collector" from "us[ing] any false, deceptive, or misleading representation or means in connection with the collection of any debt," including "false[ly] represent[ing] . . . the character, amount, or legal status of any debt." 15 U.S.C. § 1692e. The FDCPA

further prohibits a debt collector from "us[ing] unfair or unconscionable means to collect or attempt to collect any debt," including collecting any amount that is not "expressly authorized by the agreement creating the debt or permitted by law." *Id.* § 1692f. A "debt collector" under the statute is "any person . . . in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect . . . debts owed or due or asserted to be owed or due another." *Id.* § 1692a.

Midland moved to dismiss Johnson's claim. Pet. App. 18a. The District Court recognized that it was bound by the Eleventh Circuit's decision in *Crawford v. LVNV Funding, LLC*, 758 F.3d 1254 (11th Cir. 2014), *cert. denied*, 135 S. Ct. 1844 (2015), that filing a proof of claim in bankruptcy to collect a time-barred debt is a violation of the FDCPA. Pet. App. 19a. Nevertheless, the court held that the FDCPA prohibition on filing stale proofs of claim is in "irreconcilable conflict" with section 501(a) of the Bankruptcy Code, which provides in permissive terms that "[a] creditor . . . may file a proof of claim." 11 U.S.C. § 501(a). The court held that where, as is the case under Alabama law, a statute of limitations period only extinguishes a creditor's remedy but not the underlying right to payment, a creditor has the right to file a proof of claim on a time-barred debt under section 501. Pet. App. 22a. The court then found that this right is in conflict with the FDCPA because a creditor may

comply with the FDCPA only by "surrendering its right under the Code to file a proof of claim on a time-barred debt." Pet. App. 33a. Because the Bankruptcy Code was enacted after the FDCPA, the court held that the former impliedly repealed the latter. Pet. App. 31a, 37a.

On appeal, the Eleventh Circuit reversed. The court first noted that it had faced a "nearly identical" question in *Crawford* and confirmed its decision in that case that filing a stale proof of claim in bankruptcy constitutes a violation of the FDCPA. Pet. App. 5a. The Eleventh Circuit also disagreed with the lower court's conclusion that the FDCPA and the Bankruptcy Code conflicted irreconcilably. Pet. App. 7a. The court held that the FDCPA and the Bankruptcy Code "differ in their scopes, goals, and coverage, and can be construed together in a way that allows them to coexist." Pet. App. 11a. The Bankruptcy Code allows—but does not require—all creditors to file proofs of claim, while the FDCPA prohibits those creditors that qualify as "debt collectors" from filing stale proofs of claim. Pet. App. 12a, 14a. Reasoning that the Bankruptcy Code's filing rules "do not shield debt collectors from the obligations that Congress imposed on them," the Eleventh Circuit concluded that a debt collector that chooses to file a time-barred proof of claim "is simply opening himself up to a potential lawsuit for an FDCPA violation." Pet. App. 13a-14a.

SUMMARY OF THE ARGUMENT

The Eleventh Circuit correctly held that Midland violated the FDCPA by filing a proof of claim for a time-barred debt in Johnson's bankruptcy proceeding and that the Bankruptcy Code did not implicitly repeal the FDCPA as to proofs of claim filed in bankruptcy. Federal courts have widely recognized that filing or threatening to file a lawsuit to collect a debt that is barred by the applicable statute of limitations is a violation of the FDCPA. *See, e.g., Phillips v. Asset Acceptance, LLC*, 736 F.3d 1076, 1079 (7th Cir. 2013). A proof of claim filed in a bankruptcy proceeding is the equivalent of a lawsuit to collect a debt and, like a separately filed lawsuit, filing a proof of claim for a time-barred debt is an act to collect a debt "which the debt collector knows or should know is unavailable or unwinnable" and "is the kind of abusive practice the FDCPA was intended to eliminate." *Herkert v. MRC Receivables Corp.*, 655 F. Supp. 2d 870, 876 (N.D. Ill. 2009) (citation and quotation marks omitted). Midland's attempts to distinguish the two scenarios fall short, and the decision below holding that the filing of a stale proof of claim violates the FDCPA should be affirmed.

Furthermore, the Bankruptcy Code in no way precludes application of the FDCPA to stale proofs of claim. The starting point for all statutory interpretation is the text of the statute itself. *See Lamie v. U.S. Trustee*, 540 U.S. 526,

534 (2004). On its face, the FDCPA prohibits debt collectors from "us[ing] any false, deceptive, or misleading representation or means in connection with the collection of any debt," 15 U.S.C. § 1692e, and from "us[ing] unfair or unconscionable means to collect or attempt to collect any debt," *id.* § 1692f. There is no exception in these provisions for debt collectors acting within a bankruptcy proceeding, and the statute therefore clearly applies to misleading, unfair, or unconscionable attempts to collect a debt through a proof of claim. Further, nothing in the Bankruptcy Code excepts application of the FDCPA to a debt collector filing a proof of claim, and the provisions are not "irreconcilably conflicted" such that this Court should infer repeal of the FDCPA by the Code. Moreover, it is a cardinal rule of statutory construction that "repeals by implication are not favored and will not be presumed unless the intention of the legislature to repeal is clear and manifest." *Nat'l Ass'n of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 662 (2007) (citation and quotation marks omitted). Here there is no evidence that Congress intended the Code to repeal the FDCPA in this setting, let alone evidence sufficient to satisfy the "clear and manifest" standard. Where, as here, two statutes may coexist and the requisite intent to infer repeal does not exist, the courts must regard both provisions as effective. *See J.E.M. Ag Supply, Inc. v. Pioneer Hi-Bred Int'l, Inc.*, 534 U.S. 124, 143-44 (2001).

The Eleventh Circuit properly did so, and this Court should affirm.

ARGUMENT

I. Knowingly Filing A Proof Of Claim For A Time-Barred Debt Is A Violation Of The FDCPA.

A. Filing a Proof of Claim is an Act to Collect a Debt Analogous to Filing a Traditional Debt-Collection Lawsuit.

Federal courts have widely held that filing or threatening to file a lawsuit to collect a time-barred debt is a violation of the FDCPA. *See Phillips v. Asset Acceptance, LLC*, 736 F.3d 1076, 1079 (7th Cir. 2013); *accord Buchanan v. Northland Grp., Inc.*, 776 F.3d 393, 399-400 (6th Cir. 2015) (letter offering settlement of time-barred claim was a violation of FDCPA because "consumers might still be confused about the enforceability of a debt"); *Huertas v. Galaxy Asset Mgmt.*, 641 F.3d 28, 33 (3d Cir. 2011) (recognizing that threatened or actual litigation on a time-barred debt is a violation of the FDCPA, but finding no threat of litigation); *Castro v. Collecto, Inc.*, 634 F.3d 779, 783 (5th Cir. 2011) (recognizing that "threatening to sue on time-barred debt may well constitute a violation of the FDCPA," but finding that claim was not time-barred); *Freyermuth v. Credit Bureau Servs., Inc.*, 248 F.3d 767, 771 (8th Cir. 2001) (same as

Huertas).[2] As one court has explained, "bringing or threatening to bring a lawsuit 'which the debt collector knows or should know is unavailable or unwinnable by reason of a legal bar such as the statute of limitations is the kind of abusive practice the FDCPA was intended to eliminate.'" *Herkert*, 655 F. Supp. 2d at 876 (quoting *Ramirez v. Palisades Collection LLC*, No. 07-3840, 2008 WL 2512679, at *5 (N.D. Ill. June 23, 2008)); *see also Beattie*, 754 F. Supp. at 393 ("[T]he [FDCPA] was designed to prevent debt collectors from threatening suit against persons whom the collector knows or should know are not legally liable for a debt."). As these decisions recognize, a lawsuit premised or threatened on the basis of a stale claim is an abuse of the litigation system. A proof of claim premised on the basis of a stale claim is fundamentally no different.

In all material respects, the act of filing a proof of claim in a bankruptcy case is the func-

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[2] *See also Herkert v. MRC Receivables Corp.*, 655 F. Supp. 2d 870, 875 (N.D. Ill. 2009); *Larsen v. JBC Legal Grp., P.C.*, 533 F. Supp. 2d 290, 302 (E.D.N.Y. 2008); *Goins v. JBC & Assocs., P.C.*, 352 F. Supp. 2d 262, 272 (D. Conn. 2005); *Beattie v. D.M. Collections, Inc.*, 754 F. Supp. 383, 393 (D. Del. 1991); *Kimber v. Fed. Fin. Corp.*, 668 F. Supp. 1480, 1487 (M.D. Ala. 1987).

tional equivalent of commencing litigation to collect a debt outside the bankruptcy process. To begin with, a debtor commences a court-supervised bankruptcy case by filing a bankruptcy petition. 11 U.S.C. § 301. In turn, the filing of the petition triggers the automatic stay, which generally bars creditors from pursuing debt-collection activity outside the bankruptcy process. 11 U.S.C. § 362.

In lieu of pursuing immediate litigation outside the bankruptcy process, creditors may, but are not required to, file proofs of claim setting forth the debts they assert they are owed. 11 U.S.C. § 501(a). The point is to give creditors who are stayed from pursuing legitimate debt-collection activity outside the bankruptcy system an opportunity to assert legitimate claims through the proof of claim procedure. In other words, the point is to provide a means for the creditor to be paid something on its claim, a classic debt-collection activity. In the event a creditor invokes the bankruptcy debt-collection procedure improperly by filing a proof of claim seeking to collect an unenforceable debt, the Code clearly provides that such claims must be disallowed. 11 U.S.C. § 502(b)(1). And the fact that such claims must be disallowed under section 502 dramatically undercuts any notion that it is somehow legitimate for creditors to file such claims in the first instance.

Although the proof of claim process acts generally as a non-bankruptcy litigation substitute, the filing of a proof of claim can easily morph into formal debt-collection litigation, either within or outside the bankruptcy court. For example, where a creditor has filed a proof of claim, relief from stay may be granted so that the claim may be liquidated in a traditional litigation forum, leaving only the consideration of unique aspects of bankruptcy law to be adjudicated in the bankruptcy court. *See, e.g., Baldino v. Wilson (In re Wilson)*, 116 F.3d 87, 91 (3d Cir. 1997) (allowing relief from stay to "expedite the resolution of [the state tort] claim by eliminating it if [the debtor] prevails on appeal, or by rendering it final and nondischargeable if [the plaintiff] prevails"); *In re Chacon*, 438 B.R. 725, 736 (Bankr. D. N.M. 2010) ("A number of courts have . . . come up with the same solution: permit the liability and damages issues to be determined either in the state court or the U.S. district court, and then have the parties return to the bankruptcy court as needed for an adjudication of the dischargeability issue."); *In re Cummings*, 221 B.R. 814, 819 n.9 (Bankr. N.D. Ala. 1998) ("Numerous courts have determined that, under appropriate circumstances, a bankruptcy court may grant relief from the stay to allow a debt to be liquidated in a pending state court proceeding, and then make a determination of dischargeability based on the state court record."). In such circumstances where relief from stay has been granted

and the creditor pursues a time-barred lawsuit against the debtor, the creditor's claim would obviously be subject to any statute of limitations defense, and the pursuit of the litigation itself may well violate the FDCPA under the precedents discussed above. *See, e.g., Phillips*, 736 F.3d at 1079; *Kimber*, 668 F. Supp. at 1487 (finding an FDCPA violation because "time-barred lawsuits are, absent tolling, unjust and unfair as a matter of public policy").

Alternatively, creditors may file proofs of claim and have their claims adjudicated entirely in the bankruptcy court. Once again, such proofs of claim are likewise subject to any available statute of limitations defense and, if time-barred, must be disallowed as unenforceable under section 502 of the Bankruptcy Code. 11 U.S.C. § 502(b)(1). The question is whether, for purposes of the FDCPA, debt-collection activity involving the filing of a proof of claim should be viewed differently from the very non-bankruptcy debt-collection activity that the proof of claim process substitutes for and closely tracks. The answer is that, for purposes of the FDCPA, there is simply no basis for treating them differently.

To begin with, just like a debt collector who threatens or commences a traditional lawsuit on a debt he knows is stale, a debt collector who knowingly files a proof of claim for a time-barred debt is plainly seeking to collect a debt that the

collector "knows or should know is unavailable or unwinnable by reason of a legal bar." *Herkert*, 655 F. Supp. 2d at 876 (citation and quotation marks omitted). Such conduct is precisely "the kind of abusive practice the FDCPA was intended to eliminate." *Id.*; *see also Beattie*, 754 F. Supp. at 393. Thus, a debt collector's filing of a proof of claim on a debt he knows is time-barred is similarly "unjust and unfair as a matter of public policy" and violates the FDCPA for the same reasons applicable to a traditional debt-collection lawsuit. *Kimber*, 668 F. Supp. at 1487; *see also McMahon v. LVNV Funding, LLC*, 744 F.3d 1010, 1020 (7th Cir. 2014) ("Whether a debt is legally enforceable is a central fact about the character and legal status of that debt. A misrepresentation about that fact thus violates the FDCPA.").

The parallel between a proof of claim and a traditional debt-collection lawsuit is even more apparent in the scenario in which a debtor in bankruptcy objects to a proof of claim and files a counterclaim. A claim combined with an objection and counterclaim gives rise to an "adversary proceeding" under the Bankruptcy Rules, which is just the bankruptcy term for what amounts to a traditional lawsuit commenced by a summons and complaint. *See* FED. R. BANKR. P. 3007(b); FED. R. BANKR. P. 7001 (defining adversary proceedings); *see also, e.g., Mulvania v. United States (In re Mulvania)*, 214 B.R. 1, 7 (B.A.P. 9th

Cir. 1997) (objection to claim joined with request to determine validity of lien is an adversary proceeding).

Notably, an adversary proceeding is a separate piece of litigation from the overarching bankruptcy case and in large part mirrors litigation that occurs outside the bankruptcy context. *See, e.g., Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440, 457 (2004) (Thomas, J., dissenting) ("The similarities between adversary proceedings in bankruptcy and federal civil litigation are striking."); *Estancias La Ponderosa Dev. Corp. v. Harrington (In re Harrington)*, 992 F.2d 3, 6 n.3 (1st Cir. 1993) (noting "[t]he great similarity between an adversary proceeding in bankruptcy and an ordinary civil action"). The Bankruptcy Rules incorporate the Federal Rules of Civil Procedure in adversary proceedings, making discovery and pretrial procedure in an adversary proceeding largely identical to that in traditional civil litigation. *See* FED. R. BANKR. P. 7016 (adopting FED. R. CIV. P. 16 regarding pretrial conferences); FED. R. BANKR. P. 7026-7037 (adopting discovery rules in FED. R. CIV. P. 26 to 37). Post-trial procedures to alter or amend a judgment or move for a new trial are also the same in an adversary proceeding as in civil litigation. FED. R. BANKR. P. 7052, 9023, 9024. The filing of a proof of claim, therefore, can easily give rise to a distinct piece of litigation virtually indistinguishable from ordinary civil litigation. Because of these similarities, it would be illogical

to recognize the applicability of the FDCPA with respect to debt-collection activity involving an ordinary lawsuit but not debt-collection activity involving a proof of claim.

B. Midland's Proffered Reasons to Preclude Application of the FDCPA to Proofs of Claim are Equally Applicable to, and Have Long Been Rejected in the Context of, Traditional Debt-Collection Lawsuits.

In spite of the similarities between the filing of a proof of claim on a stale debt and a traditional lawsuit premised on the same stale debt, Midland nonetheless insists that the filing of a proof of claim cannot be a violation of the FDCPA because "[d]ebt recovery within bankruptcy is fundamentally different from debt collection outside bankruptcy." Pet. Br. 34. None of the "differences" that Midland identifies, however, justify creating an exception under the FDCPA for the filing of proofs of claim on debts that are known to be stale.

According to Midland, "debtors in bankruptcy are protected by a panoply of procedures," including the assignment of a trustee (and often counsel) to object to claims, regulations governing the content of proofs of claim and the procedures for administering them, and sanctions for abusive conduct. Pet. App. 31-32. But similar protections exist for debtors outside of bankruptcy. And just as none of these protections excuse

application of the FDCPA in traditional litigation, the protections Midland identifies do not excuse the application of the FDCPA to debt-collection activity involving a proof of claim.

For example, under both state and federal law, traditional complaints must meet all applicable pleading standards or risk dismissal. *See, e.g.*, FED. R. CIV. P. 8(a)(2) (a complaint must include a "short and plain statement of the claim showing that the pleader is entitled to relief"); ALA. R. CIV. P. 8(a) (same); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007) (dismissing a complaint that did not provide "enough facts to state a claim to relief that is plausible on its face"). Moreover, where counsel are involved, they must certify that the relevant pleadings are true and well-founded. For example, an attorney signing a pleading in federal court certifies that a reasonable inquiry has been made regarding the truth of the factual allegations contained therein, the claims are warranted, and the pleading is not motivated by an improper purpose. FED. R. CIV. P. 11; *see also, e.g.*, ALA. R. CIV. P. 11. Under these standards, knowingly filing a time-barred lawsuit has been held to be sanctionable conduct. *See Kimber*, 668 F. Supp. at 1488 (citing cases). But that does not mean that the FDCPA also does not apply.

By the same token, the mere fact that certain bankruptcy procedures may also shield a debtor

from certain kinds of harm arising from illegitimate proofs of claim is not sufficient reason to excuse application of the FDCPA, which has its own focus and remedial scope. The relevant inquiry in determining if a debt-collection action violates the FDCPA is whether a debt collector's conduct is misleading or deceptive, not whether other potential safeguards are in place to further combat abuses. *See, e.g., Freyermuth*, 248 F.3d at 771 ("The case law on this issue focuses on the debt collector's actions, and whether an unsophisticated consumer would be harassed, misled or deceived by them.").

Midland also contends that the FDCPA does not apply to proofs of claim premised on time-barred debts because a creditor has the right under the Bankruptcy Code to file a proof of claim and the debtor may always raise any applicable statute of limitations as a defense. Pet. Br. 18-19. But the same thing can be said of traditional debt-collection litigation: the creditor has the right to file a complaint and the debtor may raise any applicable statute of limitations as a defense. *See Goins*, 352 F. Supp. 2d at 272. Notably, courts have consistently rejected this argument as a reason to avoid application of the FDCPA to time-barred lawsuits. *Id.* (although statute of limitations is an affirmative defense that can be waived, it is "a complete defense" and "the threat to bring a suit under such circumstances can at best be described as a 'misleading'

representation"); *Kimber*, 668 F. Supp. at 1488 (rejecting assertion that "because a statute of limitations is an affirmative defense which is waived if not raised, a plaintiff may not be penalized for knowingly filing a time-barred suit"). The same reasoning applies to proofs of claim.

II. The FDCPA Covers Proofs Of Claim Premised on Stale Debts Filed In Bankruptcy Proceedings.

A. The Plain Meaning of the FDCPA Compels its Application in the Claims Process.

In construing and applying a statute, "[t]he starting point . . . is the existing statutory text." *Lamie v. U.S. Trustee*, 540 U.S. 526, 534 (2004) (citing *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 438 (1999)); *see also United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989) ("The task of resolving the dispute over the meaning of [the statutory provision at issue] begins where all such inquiries must begin: with the language of the statute itself."). In addition, "when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (citations and quotation marks omitted); *see also Rake v. Wade*, 508 U.S. 464, 471 (1993); *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992). That is because a cardinal

presumption is that Congress "says in a statute what it means and means in a statute what it says there." *Germain*, 503 U.S. at 254. Similarly, courts must also generally refrain from engrafting limitations on statutory provisions that do not appear in its text. *See, e.g., Lamie*, 540 U.S. at 538.

On its face, the FDCPA prohibits debt collectors from "us[ing] any false, deceptive, or misleading representation or means in connection with the collection of any debt," including "false[ly] represent[ing] . . . the character, amount, or legal status of any debt," 15 U.S.C. § 1692e. The FDCPA also prohibits a debt collector from "us[ing] unfair or unconscionable means to collect or attempt to collect any debt," including collecting any amount that is not "expressly authorized by the agreement creating the debt or permitted by law." *Id.* § 1692f. There is no exception in the statute for filing proofs of claim in a bankruptcy proceeding. Rather, the FDCPA provides its own protections by expressly applying only to creditors that qualify as "debt collectors" and allowing a safe harbor for those debt collectors whose violations are "not intentional and resulted from a bona fide error." *Id.* § 1692k(c).

A debt collector who knowingly attempts to collect a claim by filing a proof of claim premised on a time-barred debt violates the FDCPA no less than a debt collector who knowingly threat-

ens to file or files a traditional lawsuit premised on the same time-barred debt. Both acts fall squarely within the plain terms and remedial scope of the FDCPA, and this Court should enforce the statute according to its plain terms. *Hartford Underwriters*, 530 U.S. at 6. To read into the statute an exception for proofs of claim filed with a bankruptcy court would improperly apply a limitation to the statute that simply does not exist. *See Lamie*, 540 U.S. at 538.

B. Nothing in the Bankruptcy Code Prevents the Application of the FDCPA to a Proof of Claim for a Time-Barred Debt.

The Bankruptcy Code does not supply the full universe of laws and rules that govern the conduct of bankruptcy proceedings. *See, e.g.,* 28 U.S.C. § 959(b) (requiring any trustee, receiver, or debtor in possession to "manage and operate the property in his possession . . . according to the requirements of the valid laws of the State in which such property is situated"); *Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Prot.*, 474 U.S. 494, 507 (1986) (finding that "[t]he Bankruptcy Court does not have the power to authorize an abandonment without formulating conditions that will adequately protect the public's health and safety" as required by state law). Although it is certainly true that provisions such as the automatic stay proscribe certain conduct, it is equally true that Congress did not intend for

parties in bankruptcy "to have *carte blanche* to ignore nonbankruptcy law." *Id.* at 502.

Section 501 of the Bankruptcy Code provides that "a creditor . . . *may* file a proof of claim." 11 U.S.C. § 501(a) (emphasis added). This provision is permissive, not mandatory. In comparison, the FDCPA prohibits a "debt collector" from using "any false, deceptive, or misleading representation" or "unfair or unconscionable means" to collect a debt, 15 U.S.C. §§ 1692e, 1692f, unless the debt collector can show by a preponderance of the evidence that its FDCPA violation "was not intentional and resulted from a bona fide error," *id.* § 1692k(c). Nothing in section 501 creates an exception to the FDCPA for creditors filing proofs of claim in bankruptcy proceedings or suspends the operation of the FDCPA in the bankruptcy context. As this Court has stated, "[t]he courts are not at liberty to pick and choose among congressional enactments, and when two statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." *Morton v. Mancari,* 417 U.S. 535, 551 (1974).

As there is nothing in the language of section 501 that negates application of the FDCPA to debt collectors who file proofs of claim that are "false, deceptive, or misleading" or "unfair or unconscionable," application of the FDCPA should continue in the absence of a clearly stated

congressional expression to the contrary. *See Fourco Glass Co. v. Transmirra Prods. Corp.,* 353 U.S. 222, 227 (1957) ("It will not be inferred that Congress, in revising and consolidating the laws, intended to change their effect unless such intention is clearly expressed."); *Green v. Bock Laundry Mach. Co.,* 490 U.S. 504, 521 (1989) (party contending Congress changed settled law has burden of showing intent). There is no such expression in section 501 (or anywhere else in the Bankruptcy Code), and this Court should accordingly conclude that both laws are effective.

C. The Enactment of the Bankruptcy Code Did Not Impliedly Repeal the FDCPA as it Applies to Proofs of Claim.

A cardinal rule of statutory construction that has often been repeated by this Court is that repeals by implication are not favored and will not be found unless the congressional intent to repeal is "clear and manifest." *Red Rock v. Henry*, 106 U.S. 596, 602 (1883); *accord Nat'l Ass'n of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 662 (2007); *Rodriguez v. United States*, 480 U.S. 522, 524 (1987); *Posadas v. Nat'l City Bank of New York*, 296 U.S. 497, 503 (1936). The party urging repeal "bears a heavy burden of persuasion" in establishing such intent, *Amell v. United States*, 384 U.S. 158, 165 (1966), and this Court has stated repeatedly that "repeals by implication are not favored." *Nat'l Ass'n of Home

Builders, 551 U.S. at 662 (citation and quotation marks omitted); *see also Branch v. Smith*, 538 U.S. 254, 273 (2003); *Crawford Fitting Co. v. J.T. Gibbons, Inc.*, 482 U.S. 437, 442 (1987); *Tennessee Valley Auth. v. Hill*, 437 U.S. 153, 189 (1978); *United States v. Borden Co.*, 308 U.S. 188, 198 (1939). This Court has made clear that it "will not infer a statutory repeal unless the later statute expressly contradict[s] the original act or unless such a construction is absolutely necessary . . . in order that [the] words [of the later statute] shall have any meaning at all." *Nat'l Ass'n of Home Builders*, 551 U.S. at 662 (alterations in original) (citations and quotation marks omitted).

This Court has identified two specific situations in which repeal by implication may occur: "where provisions in two statutes are in 'irreconcilable conflict,' or where the latter Act covers the whole subject of the earlier one and 'is clearly intended as a substitute.'" *Branch*, 538 U.S. at 273 (quoting *Posadas*, 296 U.S. at 503). Midland does not claim that section 501 of the Bankruptcy Code covers the whole subject of, or is clearly intended to substitute for, the FDCPA. Midland's sole contention is that the statutes "irreconcilably conflict" and that the FDCPA must yield to the later-enacted Bankruptcy Code. *See* Pet. Br. 43-44.

Irreconcilability may be found only where it is "impossible for both provisions under consideration to stand." *Wilmot v. Mudge*, 103 U.S. 217, 221 (1880); *see also Morton*, 417 U.S. at 550 (no implied repeal where the statutes in question "can readily co-exist"). Under this stringent standard, courts may find irreconcilable conflict only where there is "a clear repugnancy between the old law and the new." *Georgia v. Pennsylvania R.R. Co.*, 324 U.S. 439, 457 (1945), *reh'g denied*, 324 U.S. 890 (1945); *accord Tennessee Valley Auth.*, 437 U.S. at 190. Where a party advocating for repeal fails to meet the heavy burden of demonstrating that two statutes cannot, under any circumstances, be reconciled, courts must apply both provisions. *J.E.M. Ag Supply, Inc. v. Pioneer Hi-Bred Int'l, Inc.*, 534 U.S. 124, 143-44 (2001) ("[W]hen two statutes are capable of coexistence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." (quoting *Morton*, 471 U.S. at 551)); *see also Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 155 (1976) ("It is not enough to show that the two statutes produce differing results when applied to the same factual situation, for that no more than states the problem.").

Under its longstanding precedents, this Court should not infer repeal of the FDCPA as to proofs of claim filed in bankruptcy unless such a inference "is absolutely necessary . . . in order that

the words of the [Bankruptcy Code] shall have any meaning at all." *Nat'l Ass'n of Home Builders*, 551 U.S. at 662. Midland, of course, cannot meet the heavy burden of showing such a necessity exists because the Bankruptcy Code simply does not prohibit what the FDCPA directs. Once again, section 501 merely provides that "a creditor . . . *may* file a proof of claim." 11 U.S.C. § 501(a) (emphasis added). In contrast, the FDCPA prohibits a "debt collector" from using "any false, deceptive, or misleading representation" or "unfair or unconscionable means" to collect a debt. 15 U.S.C. §§ 1692e, 1692f. A "debt collector" is defined as "any person . . . in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect . . . debts owed or due or asserted to be owed or due another." *Id.* § 1692a. Thus, while creditors generally are permitted to file proofs of claim in a debtor's bankruptcy proceeding, the select creditors who also qualify as "debt collectors" violate the FDCPA by knowingly and intentionally choosing to file a proof of claim on a time-barred debt.

Debt collectors can easily comply with both the Bankruptcy Code and the FDCPA, and it is therefore in no way "impossible for both provisions . . . to stand." *Wilmot*, 103 U.S. at 221. A debt collector is free to choose to file only proofs of claim that do not violate the FDCPA. The two provisions clearly "are capable of coexistence,"

and it therefore "is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." *J.E.M. Ag Supply, Inc.*, 534 U.S. at 143-44.

But even if the FDCPA and the Bankruptcy Code could be said to "irreconcilably conflict" in some sense, repeal by implication is still not appropriate unless the legislature's intent to cause such a result is "clear and manifest." *Posadas*, 296 U.S. at 503; *see also Nat'l Ass'n of Home Builders*, 551 U.S. at 662; *Rodriguez*, 480 U.S. at 524. As the court below acknowledged, and Midland does not dispute, there was no "clear and manifest" Congressional intent to repeal the FDCPA with the enactment of the Bankruptcy Code. Pet. App. 14a ("Congress never expressed a 'clear and manifest' intent to repeal the protections of the FDCPA when it enacted the Bankruptcy Code only a year later."). In fact, Midland essentially concedes that the burden of establishing "clear and manifest" intent is not met here, but claims that because the conflict "has arisen through judicial interpretation, Congress had no reason specifically to address that application [of the FDCPA] when it enacted the Bankruptcy Code," and that addressing the conflict at that time in fact "would have required an act of clairvoyance." Pet. Br. 43. In support of this assertion, Midland cites *United States v. Fausto*, 484 U.S. 439 (1988), but that case in no way excuses the requirement of "clear and manifest" intent to

infer a statute's repeal. In *Fausto*, the Court held that the Civil Service Reform Act ("CSRA"), under which certain employees have no administrative or judicial review of adverse personnel actions, precluded such employees from seeking judicial review of a personnel action based on the Back Pay Act. *Id.* at 447. While the Court held that there was no need for an "express statement" of repeal, *id.* at 453, the Court found ample support in the purpose behind the CSRA and the language of the act as a whole to conclude that Congress intended to preempt application of the Back Pay Act to personnel actions governed by the CSRA. *See id.* at 447 ("In the context of the entire statutory scheme, we think it displays a clear congressional intent to deny the excluded employees the protections of Chapter 75—including judicial review—for personnel action covered by that chapter."). No similar indicia of intent are present with respect to the relevant statutes here, and Midland simply cannot circumvent the well-established criteria that clear and manifest intent must exist for the Court to find an implied repeal. *See, e.g., Morton*, 417 U.S. at 550 (declining to find implied repeal where "nothing in the legislative history . . . indicates affirmatively any congressional intent to repeal").

CONCLUSION

For the foregoing reasons, as well as those briefed by Respondent, the decision of the court below should be affirmed.

Respectfully submitted,

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Bankruptcy Law Letter

JULY 2016 | VOLUME 36 | ISSUE 7

Is a Fraudulent Transfer Actually an "Actual Fraud"?

By Ralph Brubaker

That was the difficult and interesting question posed in the *Husky International Electronics, Inc. v. Ritz* case,[1] recently decided by the Supreme Court, with the "actual fraud" statutory language at issue being that of the discharge exception of Code § 523(a)(2)(A) for "actual fraud" debts. The debtor, though, and Justice Thomas, taking up the debtor's cause in dissent, "concede[d] that fraudulent conveyances are a form of 'actual fraud.' "[2] The majority, thus, was undoubtedly reassured in its ultimate conclusion, holding that "[t]he term 'actual fraud' in § 523(a)(2)(A) encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation."[3] The majority simply could "see no reason to craft an artificial definition of 'actual fraud' "[4] that would categorically exclude fraudulent conveyances from its ambit. Ironically, though (or perhaps fittingly), the meaning of "actual fraud" in this context is itself deceptively unclear, and the full implications of the *Husky* holding are also subject to uncertainty.

The circumstances in which the *Husky* holding will be implicated may well be rare and unusual (which was Justice Sotomayor's implicit prediction in her opinion for the 7-1 majority)—applicable principally when the *transferee* of a fraudulent transfer files bankruptcy. The instincts driving the *Husky* holding are apparent, though, and the facts of *Husky* itself are illustrative. *Husky*, then, is a useful case for exploring how a fraudulent transfer can give rise to a nondischargeable debt for "actual fraud."

Husky: Fraudulent Transfers, Alter Ego Liability, and Nondischargeable Debts for "Actual Fraud"

The facts, as found by the bankruptcy court, are as follows: Husky is a supplier of electronic device components, and between 2003 and 2007, Husky sold such components to Chrysalis Manufacturing Corp. At all relevant times, Daniel Lee Ritz, Jr. was a director and at least 30% owner of Chrysalis, and Ritz was in financial control of Chrysalis. Ritz also controlled a number of other corporations. Chrysalis was operational during this 2003-2007 period that it was purchasing product from Husky, but Chrysalis was not paying its

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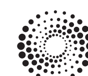

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debts as they became due, and Chrysalis ultimately owed Husky over $160,000 for goods purchased but not paid for. Moreover, between November 2006 and May 2007, Ritz orchestrated a series of cash transfers, totaling nearly $1.2 million, from Chrysalis to the other Ritz-controlled entities. "As a result of these transfers," Chrysalis "was drained of all its cash and, therefore, could not pay its creditors" such as Husky.[5] And with respect to all of these transfers, the bankruptcy court found that (1) Chrysalis was insolvent both before and after the transfer, and (2) Chrysalis did not receive reasonably equivalent value in exchange for any of the transfers.

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BANKRUPTCY LAW LETTER (USPS 674-930) (ISSN 0744-7871) is issued monthly, 12 times per year; published by Thomson Reuters, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526. Periodicals postage paid at St. Paul, MN, and additional mailing

Subscription Price: For subscription information call (800) 221-9428, or write West, Credit Order Processing, 620 Opperman Drive, P.O. Box 64833, St. Paul, MN 55164-9754.

POSTMASTER: Send address changes to: *Bankruptcy Law Letter,* 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526.

In June 2007, Husky sued Chrysalis, Ritz, and several of the Ritz-controlled entities in Texas state court, seeking to collect the unpaid debt. A year later, though, Chrysalis filed a Chapter 7 petition, staying the pending Texas state-court suit as against Chrysalis. Thereafter, in May 2009, Husky sued Ritz in federal district court, asserting that Ritz was personally liable for Chrysalis' debt to Husky under an alter-ego veil-piercing theory of liability. That suit was stayed in December 2009, however, when Ritz filed a Chapter 7 petition. Husky responded by reasserting its alter ego claim via an adversary proceeding in Ritz's Chapter 7 case, alleging that (1) Ritz was personally liable for Chrysalis' corporate debt to Husky, and (2) that debt was nondischargeable under, inter alia, Code § 523(a)(2)(A).

Code § 523(a)(2)(A), in relevant part, excepts from discharge "any debt for money, property, services, or . . . credit, to the extent obtained by false pretenses, a false representation, or actual fraud." The sticking point in *Husky*, though, was that Ritz never made any false representations to Husky. Indeed, Ritz had no communication with Husky at all until *after* Husky had already sold its product to Chrysalis and Chrysalis thus had already incurred the unpaid debt to Husky. The question, therefore, was whether Ritz nonetheless could have incurred a debt to Husky for "actual fraud," in the absence of any false representations by Ritz.

Alter Ego Liability for "Actual Fraud" Under Texas Corporate Law

Of course, an essential logical requisite to the nondischargeability of a debtor's debt is that the debtor actually owes a debt to the creditor at issue under applicable nonbankruptcy law, and in the bankruptcy court, Ritz contested Husky's assertion that Ritz was personally liable for Chrysalis' corporate debt to Husky. By statute, under applicable Texas corporate law, a contract creditor such as Husky can pierce the corporate veil of a corporation and hold a controlling shareholder such as Ritz personally liable for a corporate contract debt only "if the obligee demonstrates that the . . . beneficial owner . . . caused the corporation to be used for the purpose of perpetrating and did perpetrate an *actual fraud* on the obligee primarily

for the direct personal benefit of the . . . beneficial owner."[6]

The bankruptcy court held that "actual fraud" within the meaning of that Texas statute must be premised upon a misrepresentation, and since Ritz made no false representations to Husky, Ritz could not be personally liable for Chrysalis' corporate debt to Husky. The district court on appeal, however, concluded (1) that the "actual fraud" required for veil piercing under Texas law need not involve a misrepresentation, and (2) that the requisite "actual fraud" could be established by fraudulent transfers made with "actual intent to hinder, delay, or defraud any creditor"[7] of the corporation—the so-called "actual fraud" brand of fraudulent transfer under Texas' codification of the Uniform Fraudulent Transfer Act (UFTA).[8] Furthermore, the district court determined that the bankruptcy court's findings established that the $1.2 million of cash transfers from Chrysalis to other Ritz-controlled entities were accompanied by at least four of the "badges of fraud," delineated in UFTA § 4(b) and that properly give rise to an inference of "actual intent to hinder, delay, or defraud" creditors via those transfers.[9] Thus, it was conceivable that Husky could pierce the Chrysalis corporate veil and hold Ritz personally liable for Chrysalis' debt to Husky under applicable state law.

Nondischargeability of "Actual Fraud" Debts Under Bankruptcy Code § 523(a)(2)(A)

Even if Ritz were personally liable for Chrysalis' corporate debt to Husky under applicable Texas state law, nonetheless, the bankruptcy court and, on appeal, the district court and the Fifth Circuit, in turn, all held that Ritz's debt to Husky could *not* be excepted from discharge under Code § 523(a)(2)(A) because a misrepresentation "is a necessary prerequisite for a showing of 'actual fraud' under" that nondischargeability provision.[10] Ritz's "actual intent to hinder, delay, or defraud" Chrysalis creditors, however—the basis for Ritz's liability to Husky under Texas law—did *not* involve any misrepresentations by Ritz.

That interpretation of § 523(a)(2)(A) "actual fraud," though, was at odds with that of the Seventh Circuit in the prominent case of *McClellan v. Cantrell*,[11] and shortly after the Fifth Circuit's *Ritz* decision, the First Circuit joined in the Seventh Circuit's contrary interpretation.[12] The Supreme Court, therefore, granted certiorari in *Husky* to resolve the circuit split and, reversing the Fifth Circuit, held that "[t]he term 'actual fraud' in § 523(a)(2)(A) encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation."[13]

There Is "Fraud," and Then There Is "Fraud"

The term "fraud" is steeped in a certain amount of intractable vagueness and ambiguity, and as Professor Max Radin deftly demonstrated in a 1931 law review article, those difficulties can be traced to Roman law and its subsequent influence upon English law.[14] While the term fraud is often associated with knowing, intentional acts of deceit, the root "term *fraus*, in Latin, does not really mean 'fraud' at all in the sense of 'deceit'—at any rate, not deliberate" deceit.[15]

> The [Latin] word for [deliberate deceit] is *dolus*. The word *fraus* means "prejudice" or disadvantage and it is used in that sense in a number of idiomatic expressions and formulas in legal as well as quite generally in non-legal writers. Unfortunately the word came to be applied both in legal as in non-legal writers to the quality of the act that caused the prejudice, as well as to the damage itself and so became almost—but not quite—interchangeable with *dolus*.[16]

Indeed, Roman law and usage itself seems to have initiated this indistinct amalgamation of *fraus* and *dolus*,[17] and Anglo-American usage with respect to "fraud" has inherited this ambiguity, "which has compelled us to distinguish between 'actual' fraud and 'constructive' fraud, and forced other indirections upon us."[18]

Who Put the Fraud in a Fraudulent Conveyance?

Fraudulent conveyance law is a prominent repository of the pervasive ambiguity surrounding "fraud" because "the terminology used to describe [the fraudulent debtor's] offense is taken bodily from the Roman law, where *fraus creditorum* was an elaborately developed nominate tort."[19] While there were precursors in English medieval and feudal law,[20] the famous 1571 Statute of 13 Elizabeth contained the familiar formulation providing

"for the avoiding and abolishing of feigned, covinous and fraudulent . . . conveyances . . . which . . . are devised and contrived of malice, fraud, covin, collusion, or guile, to the end, purpose, and *intent to delay, hinder or defraud creditors* . . . of their just and lawful actions, suits, debts . . . and reliefs," to the "hindrance of the due course and execution of law and justice."[21]

That primordial cause of action—to avoid transfers made with actual "intent to hinder, delay, or defraud creditors"—has been a consistent feature of every modern codification of fraudulent conveyance law, from § 67e of the original Bankruptcy Act of 1898, to § 7 of the 1918 Uniform Fraudulent Conveyance Act (UFCA), to § 67d(2)(d) of the Bankruptcy Act as amended in 1938, to § 548(a)(1) of the 1978 Bankruptcy Code (now § 548(a)(1)(A)), to § 4(a)(1) of the 1984 UFTA), which was carried forward fully intact into the recently promulgated 2014 Uniform Voidable Transactions Act (UVTA).

Fraudulent Conveyance in Fraud of Creditors as Distinguished From Fraudulent Inducement by a Fraudulent Misrepresentation

Given the intrinsic ambiguities associated with the term "fraud," it is often helpful to be more precise in specifying the "fraud" at issue. And as both the majority and the dissent in *Husky* fully recognized, there is a sharp and fundamental distinction between the "fraud" involved in (1) a transfer made with intent to *defraud creditors* that is the object of fraudulent conveyance law, and (2) the kind of *fraudulent inducement* with which the tort of *fraudulent misrepresentation* is concerned. Indeed, Justice Breyer adeptly illuminated that distinction nearly 30 years ago in a noteworthy scholarly opinion as a First Circuit judge.[22]

The tort of fraudulent misrepresentation imposes liability on "[o]ne who makes a misrepresentation . . . for the purpose of inducing another to act or to refrain from action in reliance upon it."[23] However, "[t]hat kind of fraud—dishonesty in the *creation* of the debt—is," as Justice Breyer observed, "*not* the kind of fraud that the [*fraudulent conveyance*] Act addresses" through the "intent to hinder, delay, or defraud *creditors*" term of art.[24] And Justice Sotomayor echoed the same "basic point" in *Husky*, that "fraudulent conveyances are *not* an inducement-based fraud."[25]

"Classic fraudulent conveyance law is concerned with a debtor who manipulates his assets so as to keep them from his creditors."[26] A transfer made with intent to defraud *creditors*, therefore, within the meaning of fraudulent conveyance law, is one that by its design and purpose places assets beyond creditors' reach and thus prejudices their efforts to collect on their claims by hiding or shielding assets from creditors. Fraudulent conveyance law is "concerned with transactions that shield [debtor] assets from creditors, not the manner in which specific debts were created."[27] The fraud involved in a fraudulent conveyance is a logically *ex post* fraud that essentially assumes that debts will exist and, given that assumption, employs devices designed to frustrate those creditors' access to the debtor's assets.

As Justice Sotomayor properly recognized in *Husky*, then, "[i]n such cases, the fraudulent conduct is not in dishonestly inducing a creditor to extend a debt. It is in the acts of concealment and hindrance," which may or (even more often) may not involve any misrepresentations by the fraudulent debtor.[28] Indeed, in formally changing the name of the officially recommended uniform act in 2014 from the Uniform Fraudulent Transfer Act to the Uniform Voidable Transactions Act, the Uniform Law Commission emphasized that the name change, while superficial rather than substantive,[29] nonetheless should help to make clear, inter alia, that "actual intent to hinder, delay, or defraud creditors" is directed at fraudulent conduct quite distinct from that of common-law fraudulent misrepresentation.[30]

It is far from clear, however, how that cleavage cuts when set against the language of § 523(a)(2)(A)'s specification of debts for "false pretenses, a false representation, or actual fraud," which explains the differing interpretations favored by majority and dissent in *Husky*.

Code § 523(a)(2)(A)'s Reference to "Actual Fraud"

The *Husky* majority chose to parse the wording

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of § 523(a)(2)(A) very finely, first, by isolating the phrase "actual fraud" in order to consider its meaning, as distinguished from that of its nearest neighbors, "false pretenses" and "a false representation." Then, within the phrase "actual fraud," the Court further isolated the term "fraud" in order to determine whether that term includes within its meaning a fraudulent transfer.

Actual Fraud Is Not Coextensive With a False Representation

First, in considering the statutory series "false pretenses, a false representation, or actual fraud," the *Husky* Court considered the "actual fraud" phrase to have meaning independent of "false pretenses" and "a false representation." And there is support for that approach in the Bankruptcy Code's legislative history, which indicates that " 'actual fraud' [wa]s *added as a ground* for exception from discharge" in 1978,[31] in addition to the pre-existing "false pretenses or false representations" grounds that were being carried forward from the 1898 Act.[32] Thus, the *Husky* Court thought that "[i]t is therefore sensible to start with the presumption that Congress did not intend 'actual fraud' to mean the same thing as 'a false representation,' as the Fifth Circuit's holding suggests."[33]

In fact, it is extremely odd to think that a § 523(a)(2)(A) debt must *always* be the product of a false representation, as the Fifth Circuit held, even if one accepted the view (which the Supreme Court obviously did not) that the scope of § 523(a)(2)(A) "actual fraud" is strictly confined to the common-law tort of fraudulent "misrepresentation."[34] That common law, perhaps more properly characterized as the tort of fraudulent "deceit,"[35] imposes liability for fraud even in the *absence* of any misrepresentation by the defendant, under various circumstances, for mere *nondisclosure*.[36] And the same is true for "false pretenses" liability,[37] which appears to be a term-of-art reference to the traditional criminal theft offense of obtaining property by false pretenses.[38] That kind of fraud by omission can be forced into the lexicon of fraudulent "misrepresentation" only through the euphemistic device of treating the defendant's *failure* to represent a particular fact "*as though* [the defendant] *had represented the nonexistence* of the matter that he has failed to disclose."[39] The *Husky* majority's reading of the statute, therefore, that a debt for "actual fraud" need *not* be premised upon a false representation, is fully consistent with the most common forms of both criminal and civil fraud liability.[40]

Fraud Includes Fraudulent Transfers

The *Husky* Court then made a further linguistic segmentation within the phase "actual fraud," in order to conclude that a fraudulent conveyance can be "actual fraud" within the meaning of § 523(a)(2)(A). " 'Actual fraud' has two parts: actual and fraud," with "actual" simply referring to the requisite wrongful intent for nondischargeability.[41] Thus, according to the Court, "actual fraud" within the meaning of § 523(a)(2)(A) is anything "done with wrongful intent" (*actual* fraud) "that counts as 'fraud.' "[42] And, of course, as the Court reasoned in *Field v. Mans*, that determination must be made against the background of the accumulated common-law understanding of the term "fraud."[43]

Well, as the history of fraudulent conveyance law reveals, what Ken Kettering has referred to as the "primordial rule"[44] regarding transfers made with "actual intent to hinder, delay, or defraud" creditors, has for centuries been regarded as addressing wrongful "fraudulent" conduct. Indeed, the original 1571 Statute of 13 Elizabeth was also a penal statute, and the famous 1601 fraudulent conveyance decision in *Twyne's Case* was a criminal case in the Star Chamber convicting the transferee, Twyne, of fraud.[45] Even today, there are state statutes that "criminalize a transfer made with the intent to hinder, delay, or defraud, adopting the original language of the Statute of Elizabeth,"[46] and the Model Penal Code includes similar offenses in its article dealing with "fraudulent practices."[47] It is quite natural, therefore, to conclude that § 523(a)(2)(A)'s reference to "fraud," if it means "anything that counts as 'fraud,' "[48] includes fraudulent conveyances.

The § 523(a)(2)(A) "Obtained by" Limitation As an Implicit Reference to Fraudulent Inducement Debts

In dissent, Justice Thomas "agree[d] that, generally, we should give a common-law term of art its

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established common-law meaning," and he also seemed content with the conclusion that a misrepresentation is *not* an essential element of a nondischargeable "actual fraud" debt, stating that "[a]ctual fraud is broader than false pretenses or false representations, and 'consists of any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another.' "[49] Justice Thomas also did "not quibble with the majority's conclusion that the *common-law* definition of 'actual fraud,' " in general, "included fraudulent transfers."[50] Nonetheless, he was convinced that a fraudulent conveyance is not the kind of "actual fraud" to which § 523(a)(2)(A) has reference, and he reached that conclusion by leaning upon the fundamental distinction (discussed above) between a *fraudulent conveyance* made in fraud of *creditors*, as contrasted with a *fraudulent inducement* debt.

Justice Thomas was of the opinion that the "actual fraud" reference, when considered in the context of the overarching grammatical structure of § 523(a)(2)(A), in particular its "obtained by" limitation, is referring specifically and exclusively to *fraudulent inducement* debts:

> Section 523(a)(2) covers only situations in which "money, property, [or] services" are "obtained by . . . actual fraud," and results in a debt. See *Cohen v. de la Cruz*, 523 U.S. 213, 218 (1998). The statutory phrase "obtained by" is an important limitation on the reach of the provision. Section 523(a)(2)(A) applies only when the fraudulent conduct occurs at the *inception of the debt, i.e.*, when the debtor commits a fraudulent act to induce the creditor to part with his money, property, services, or credit. The logical conclusion then is that "actual fraud"—as it is used in the statute—covers only those situations in which some sort of fraudulent conduct caused the creditor to enter into a transaction with the debtor. A fraudulent transfer generally does not fit that mold . . . . [T]he fraudulent transfer here, like all but the rarest fraudulent transfers, did not trick the creditor into selling his goods to the buyer, Chrysalis Manufacturing Corporation. It follows that the goods that resulted in the debt here were not "obtained by" actual fraud. § 523(a)(2)(A).[51]

If the "obtained by" limitation did, indeed, serve to limit § 523(a)(2)(A) to fraudulent inducement debts, then that would also necessitate interpreting the causation aspect of that phrase in a manner that limited § 523(a)(2)(A) to fraudulent inducement debts. Thus, Justice Thomas also reasoned as follows:

> [T]he plain meaning of the phrase "obtained by" . . . has an "inherent" "element of causation," and refers to those debts "resulting from" or "traceable to" fraud. *Field v. Mans*, 516 U.S. 59, 61, 64, 66 (1995). As I have stated, "in order for a creditor to establish that a debt is not dischargeable, he must demonstrate that there is a causal nexus between the fraud and the debt." Archer v. Warner, 538 U.S. 314, 325 (2003) (Thomas, J., dissenting). . . . The upshot of the phrase "obtained by" is that § 523(a)(2) covers only those debts that result from fraud at the inception of a credit transaction. Such a debt caused by fraud necessarily "*follows* a transfer of value or extension of credit induced by falsity or fraud." [*Field v. Mans*, 516 U.S., at 66] (emphasis added).[52]

That is not, however, the only possible way to interpret the "obtained by" phrase, and the *Husky* majority was not persuaded that the "obtained by" clause limits § 523(a)(2)(A) to fraudulent inducement debts.

A More Generous Construction of § 523(a)(2)(A)

If one were inclined to strictly and narrowly construe discharge exceptions in favor of the debtor, in furtherance of the fresh start policy, then Justice Thomas' interpretation of § 523(a)(2)(A) would be particularly appealing. Indeed, the Fifth Circuit invoked that maxim in *Husky*.[53] The Supreme Court, though, over a very long run of decisions,[54] has not been at all inclined toward a narrow construction of the § 523(a)(2)(A) discharge exception for fraud debts. Indeed, the Court has repeatedly done just the opposite—broadly and generously construing § 523(a)(2)(A), because a narrow construction "would not square with the intent of the fraud exception"[55] to strictly "limit[] the opportunity for a completely unencumbered new beginning to the 'honest but unfortunate debtor.' "[56] Thus, the Court has proceeded from the assumption "that 'Congress intended the fullest possible inquiry' to ensure that 'all debts arising out of' fraud are 'excepted from discharge,' no matter what their form,"[57] as "it is 'unlikely that Congress . . . would have favored the interest in giving perpetrators of fraud a fresh start.' "[58]

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Resolving all possible ambiguities in favor of *not* discharging those debts incurred with the requisite fraudulent intent, then, it is easy to understand how the *Husky* Court could conclude that the language of § 523(a)(2)(A) can comfortably comprehend a fraudulent conveyance debt.

The Debtor's Debt Versus the Creditor's Claim

What is somewhat unique about the "debt" at issue in *Husky*, and that confounds the analysis somewhat, is that Ritz's liability to Husky (whether cast as alter ego liability or fraudulent conveyance liability) did not arise from any direct dealings between Ritz and Husky. Rather, Ritz incurred secondary or derivative liability for a corporate debt that Chrysalis had previously incurred by purchasing product from Husky. The same, of course, is also true in more straightforward cases of a transferee's fraudulent conveyance liability, as illustrated by the facts of *McClellan v. Cantrell*.

In *McClellan v. Cantrell*, Creditor sold machinery to Purchaser for $200,000, on credit. Purchaser subsequently defaulted on its purchase debt to Creditor, and Creditor sued Purchaser to collect the debt and also to enjoin Purchaser from disposing of the machinery. During the pendency of Creditor's suit, Purchaser colluded with his sister, Debtor, to thwart Creditor's collection of the purchase debt via a "sale" of the machinery from Purchaser to Debtor for $10, and then Debtor turned around and sold the machinery to someone else for $160,000. When Creditor added Debtor as an additional defendant in his suit against Purchaser with a fraudulent conveyance claim, Debtor filed a Chapter 7 petition. And Creditor, of course, sought to except Debtor's fraudulent conveyance liability from discharge as a § 523(a)(2)(A) debt for "actual fraud."

As in *Husky*, then, Debtor's fraudulent conveyance liability in *McClellan* is a kind of secondary or derivative liability for Purchaser's purchase debt to Creditor. Indeed, for purposes of comparatively analyzing *Husky*, one could attach the corresponding Creditor, Purchaser, and Debtor labels to Husky, Chrysalis, and Ritz, respectively.

Notice that in order to construe § 523(a)(2)(A) as limited to fraudulent inducement debts, Justice Thomas approached the relevant "debt" at issue from Creditor's perspective: "[I]t would be nonsensical to say that a fraudulent transfer created the debt at issue," because "the debt at issue did not originate from any transaction between [Debtor] and [Creditor]."[59] Thus, Justice Thomas read "debt for money, property, services, or . . . credit . . . *obtained by* . . . actual fraud" to mean "obtained" *from Creditor* "by actual fraud." The only party with a debt for property obtained from Creditor in *Husky* and *McClellan*, though, is Purchaser, not Debtor. So § 523(a)(2)(A) can only have potential applicability to Purchaser's debt, not Debtor's, according to Justice Thomas.

As Justice Sotomayor pointed out, though, that is not what the actual language of § 523(a)(2)(A) says. "Nothing in the text of § 523(a)(2)(A) supports that additional requirement"[60] that the debt be one for money or property obtained *from Creditor*. Moreover, if our focus is upon identifying obligations *Debtor incurred* with the requisite fraudulent intent—consistent with the Court's persistent view of the function of the § 523(a)(2)(A) discharge exception—then we will approach the relevant "debt" at issue from *Debtor's perspective* rather than Creditor's. Indeed, the "debt" to which § 523(a)(2)(A) expressly has reference is simply the "debt" Debtor seeks to discharge—Debtor's debt, *not* Purchaser's debt—and the only limitation that the phrase "obtained by" imposes is that Debtor's "debt" be one "for money, property, services, or . . . credit . . . obtained by . . . actual fraud." The actual text of § 523(a)(2)(A), therefore, easily comprehends Debtor's debt in cases like *McClellan*. As Judge Posner put it in *McClellan*:

> [Debtor] is alleged to have been a full and equal participant in her brother's fraud, to have been in effect his accomplice. The debt that [Creditor] is seeking to collect from [Debtor] (and prevent her from discharging) arises by operation of law *from her fraud*. That debt [the one Debtor seeks to discharge] arose not when [Purchaser] borrowed money from [Creditor] but when [Debtor] prevented [Creditor] from collecting from [Purchaser] the money [Purchaser] owed [Creditor]. . . . [Purchaser's] original debt to [Creditor] is not the debt at issue here. The debt at issue here is the debt that [Debtor] incurred to [Creditor] by committing a fraud against [Creditor].[61]

And if one focuses on the "debt" Debtor seeks to

discharge—Debtor's fraudulent conveyance liability—the "obtained by" limitation of § 523(a)(2)(A) is easily satisfied in a case like *McClellan*, under the interpretation of that limitation announced by the Supreme Court in *Cohen v. de la Cruz*. In fact, Justice Thomas' assumption that § 523(a)(2)(A) (via the "obtained by" limitation) could *only* be referring to Purchaser's debt (and, thus, § 523(a)(2)(A) simply cannot except Debtor's debt from discharge) is inconsistent with the Court's very broad and inclusive interpretation of the "obtained by" clause in *Cohen v. de la Cruz*.

A Debt for Money or Property "Obtained by" a Fraudulent Transfer

Code § 523(a)(2)(A) excepts from discharge "any debt for money, property, services, or . . . credit, to the extent obtained by . . . actual fraud." And in *Cohen v. de la Cruz*, the Court stated that "[t]he most straightforward reading of § 523(a)(2)(A) is that it prevents discharge of 'any debt' respecting 'money, property, services, or . . . credit' that the debtor has fraudulently obtained."[62] Thus, "[o]nce it is established that specific money or property has been obtained by fraud, . . . 'any debt' arising therefrom is excepted from discharge."[63]

As applied to a case like *McClellan*, therefore, Debtor obtained the machinery from her brother by participating in his fraud upon Creditor, and thus, her consequent fraudulent transfer liability to Creditor for the value thereof is excepted from discharge. Contrary to Justice Thomas' assumption, then, that the "obtained by" phrase could *only* be referring to Purchaser's debt (and not Debtor's debt) in a case like *McClellan*, "the phrase 'to the extent obtained by' in § 523(a)(2)(A) . . . does *not* impose any limitation on the extent to which 'any debt' arising from fraud is excepted from discharge."[64] Rather, "§ 523(a)(2)(A) prevents the discharge of all liability arising from fraud."[65] The only "limitation" that the "obtained by" phrase imposes upon the scope of § 523(a)(2)(A) is that it must be "established that specific money or property has been obtained by fraud" and the debt at issue must be one " 'resulting from' or 'traceable to' [that] fraud."[66]

That required causal connection is easily and obviously present in cases like *McClellan*. As Justice Sotomayor stated in *Husky*:

> [T]he recipient of the [fraudulent] transfer—who, with the requisite intent, also commits fraud—can "obtain[n]" assets "by" his or her participation in the fraud. If that recipient later files for bankruptcy, any debts "traceable to" the fraudulent conveyance will be nondischargeable under § 523(a)(2)(A). Thus, at least sometimes a debt "obtained by" a fraudulent conveyance scheme could be nondischargeable under § 523(a)(2)(A). Such circumstances . . . make clear that fraudulent conveyances are not wholly incompatible with the "obtained by" requirement.[67]

Indeed, if one is inclined to construe the § 523(a)(2)(A) discharge exception generously, in order to "limit[] the opportunity for a completely unencumbered new beginning to the 'honest but unfortunate debtor,' "[68] the intuition that a transferee's fraudulent conveyance debt should *not* be categorically excluded from § 523(a)(2)(A) nondischargeability (as advocated by Justice Thomas) is quite compelling. As Judge Posner trenchantly observed in *McClellan*:

> The two-step routine that [Creditor] alleges and that we must take as true—in which [Purchaser] transfers valuable property to [Debtor] for nothing in order to keep it out of the hands of [Purchaser]'s creditor and Debtor then sells the property and declares bankruptcy in an effort to shield herself from liability for having colluded with [Purchaser] to defeat the rights of [Purchaser]'s creditor—is as blatant an abuse of the Bankruptcy Code as we can imagine. It turns bankruptcy into an engine for fraud.[69]

And note, that since the fraudulent transfer at issue in cases like *McClellan* and *Husky* is a transfer of Purchaser's property (rather than Debtor's property), the § 727(a)(2)(A) ground for discharge denial—that "the debtor, with intent to hinder, delay, or defraud a creditor . . . has transferred . . . *property of the debtor*, within one year before the date of the filing of the petition"—has no applicability whatsoever to penalize Debtor's fraud. Thus, the Supreme Court was entirely unmoved by the existence of the more specific discharge penalty directed at fraudulent conveyances in § 727(a)(2) and negative inference arguments therefrom, e.g., that the § 523(a)(2)(A) discharge penalty should *not*, therefore, be read to also address fraudulent conveyances via a more general "actual fraud" reference. Again, such arguments

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might have some traction if the § 523(a)(2)(A) discharge exception should be strictly and narrowly construed in favor of the debtor. But the Court evidently does *not* indulge any such debtor-friendly pro-discharge presumption and is more inclined to construe § 523(a)(2)(A) as broadly as its language permits, in the interest of *not* "giving perpetrators of fraud a fresh start."[70] And, of course, a more liberal and flexible interpretation of § 523(a)(2)(A) makes that provision much more responsive to the ever-evolving ingenious means by which fraudsters perpetrate their schemes.

The *Husky* Court, therefore, was unwilling to read the "obtained by" requirement in a manner that would categorically exclude fraudulent transfer debts from the scope of the § 523(a)(2)(A) discharge exception. The *Husky* case, though, presents another difficult issue regarding the "obtained by" requirement that the Court did not address.

Money or Property "Obtained by" Whom?

In *Cohen v. de la Cruz*, the Court stated that "[t]he most straightforward reading of § 523(a)(2)(A) is that it prevents discharge of 'any debt' respecting 'money, property, services, or . . . credit' that *the debtor has fraudulently obtained.*"[71] In *Husky*, though, the alleged fraudulent transfers at issue were made to various Ritz-controlled entities rather than to the debtor, Ritz, personally, and the Supreme Court expressly refused to take a position on whether this particular aspect of the "obtained by" requirement was satisfied in *Husky*, leaving that for determination on remand.[72]

Notwithstanding the above-quoted dicta from *Cohen v. de la Cruz*, the language of § 523(a)(2)(A) itself does *not* expressly dictate that *the debtor* must be the recipient of the money, property, services, or credit "obtained by" fraud. Thus, in the lower courts, "[t]hree views have emerged regarding the issue of whether a debtor must personally receive" the money, property, services or credit "obtained by" fraud before the § 523(a)(2)(A) discharge exception can apply.[73]

As summarized by the Eleventh Circuit in its *Bilzerian* decision, "[t]he first view, which . . . is the narrowest, requires that the debtor personally receive the fruits of the fraud."[74] Indeed, the above quotation from *Cohen v. de la Cruz* (although dicta) suggests that the narrow view is a plausible construction of the language of § 523(a)(2)(A). At the other extreme, though, the broadest view is that the statute, by its terms, merely requires that the debtor engage in fraudulent conduct through which money or property was obtained, but the "debtor does not necessarily have to receive money [or property] personally or receive any benefit at all" from his/her fraudulent conduct, for any debt resulting therefrom or traceable thereto to be nondischargeable.[75]

Most courts, however, including several circuit courts, have not followed either the narrow or broad view, but rather have adopted a middle course, which "is termed the 'receipt of benefits' theory. This theory requires that the debtor gain a *benefit* from the money [or property] that was obtained by fraudulent means."[76] Cases invoking the receipt of benefits theory typically involve facts similar to *Husky*, where entities controlled by the debtor were the recipients of the money or property obtained by fraud. In *Husky*, then, this aspect of the "obtained by" requirement would seem to be met if either the broad view or the "receipt of benefits" theory prevails, both of which are more consistent with a liberal interpretation of the scope of § 523(a)(2)(A) that does not reward the fraudster who buries the fruits of that fraud in a thicket of controlled corporate entities.

How broadly this aspect of the "obtained by" requirement is interpreted will also affect the nondischargeability of the fraudulent conveyance liability of *other* nontransferees. For example, some states recognize a civil cause of action for conspiracy to commit a fraudulent transfer[77] or for aiding and abetting a fraudulent conveyance.[78] Assuming that such actors participate in a fraudulent transfer scheme with the requisite fraudulent intent, a desire "to ensure that 'all debts arising out of' fraud are 'excepted from discharge,' no matter what their form,"[79] again, would counsel in favor of a more liberal interpretation of this aspect of the "obtained by" requirement.

Actual Fraud Requires Wrongful Intent

The premise behind a more generous interpreta-

tion of the scope of § 523(a)(2)(A) is that the debtor's liability is, indeed, attributable to purposefully wrongful conduct, because § 523(a)(2)(A) belongs to "a set of statutory [discharge] exceptions that Congress normally confines to circumstances where . . . the presence of fault"—"of the kind that the criminal law" punishes—is what compels "preserving the debt."[80] Hence, in adding the "actual fraud" ground for nondischargeability in 1978, legislative history indicates that Congress "intended to codify current case law, *e.g.*, Neal v. Clark, 95 U.S. 704 (1887), which interprets 'fraud' to mean actual or positive fraud rather than fraud implied in law."[81]

In that *Neal v. Clark* decision, the Court was interpreting the provision in the Bankruptcy Act of 1867 specifying "[t]hat no debt created by the fraud . . . of the bankrupt . . . shall be discharged,"[82] and Justice Harlan elaborated "that the 'fraud' referred to in that section means positive fraud, or fraud in fact, involving moral turpitude or intentional wrong . . . and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality."[83] And in the more recent *Bullock* case, the Court indicated[84] that "the term requires an intentional wrong," including "also reckless conduct of the kind that the criminal law often treats as the equivalent."[85] In *Husky*, the Court echoed that same "wrongful intent" standard, first articulated in *Neal v. Clark*, as providing "the requisite intent" to "commit[actual] fraud" within the meaning of § 523(a)(2)(A).[86] "Thus, anything that counts as 'fraud' and is done with wrongful intent is 'actual fraud' " falling within the discharge exception.[87]

Nondischargeability of "Actual" Fraudulent Transfer Liability

In deciding "whether there must be actual fraud, or whether it is enough that there is implied or constructive fraud" to render a debt nondischargeable,[88] Justice Harlan in *Neal v. Clark* was wrestling with the ancient, intrinsic ambiguity surrounding "fraud" inherited from Roman law, "which has compelled us to distinguish between 'actual' fraud and 'constructive' fraud, and forced other indirections upon us."[89] And, of course, fraudulent conveyance law contains one of the most prominent examples of the misleading nomenclature of "actual" and "constructive" fraud. So-called constructive "fraud" provides another instance of the beguiling nature of the legal terminology of "constructive" anything. Professor Markell has aptly described the term "constructive fraud" as "the ultimate misnomer in commercial law."[90] Constructive fraud is to actual fraud what constructive contract is to an actual contract—i.e., <u>*not*</u>.

Modern constructive fraud has its origins in two distinct lines of eighteenth and nineteenth-century case law—one involving gifts (then commonly known as "voluntary conveyances") and the other involving transfers for inadequate consideration (sometimes characterized as partial gifts or "partially voluntary" conveyances).[91] Both lines of decision can be traced to early influential opinions by Chancellor Kent.[92]

The significance of those decisions lay in the fact that in each, "Kent was unwilling to find actual fraud,"[93] yet provided a remedy nonetheless, despite the fact that the transfers at issue were not "fraudulent in fact," based simply upon "unequitable circumstances . . . which is only constructively fraudulent."[94] With respect to gifts, in particular, the absence of the requisite intent thereby to injure creditors, is widely acknowledged.[95] Kent, however, held that the fraudulent conveyance laws should reach them all the same:

> If the question rests not upon an actual fraudulent intent (as is admitted in all the cases), it must be a case of fraud in law, arising from the act of a voluntary disposition [i.e., a gift], while indebted.[96] . . . I apprehend it is, upon the whole, better and safer not to allow a party to yield to . . . natural impulse by giving him the power of placing property . . . beyond the reach of existing creditors.[97] He must be taught by the doctrines of this Court, that the claims of justice are prior to those of affection. The inclination of my mind is strongly in favor of the policy and wisdom of the rule, which absolutely disables a man from preferring, by any arrangement whatever, and with whatever intention, by gifts of his property, his [objects of natural affection] to his creditors.[98]

Such cases of constructive (i.e., <u>*not*</u>) "fraud" are fully "[d]ivorced from the mental states of the parties," and, therefore, are "avoidance actions of a different nature entirely" than the primordial actual fraudulent transfer, made with "actual intent to

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hinder, delay, or defraud any creditor."[99] "The impulse to which they respond is very different from that prohibiting transfers with actual fraudulent intent."[100] The prohibition against gifts by an insolvent captures the instinct that "you must be just before you are generous."[101] More broadly, though, the prohibition against transfers for inadequate consideration by an insolvent (Kent's allusive reference to "unequitable circumstances") and the fact that "[m]any cases fall squarely within the scope of constructive fraud even though there is no hint of [transferor] misbehavior," indicate "that some transfers by their very nature injure creditors of the" transferor: "Such transfers are inherently objectionable, and should be set aside. The focus of constructive fraud, then is on the *victims*—the creditors—rather than on the [transferor]. In short, constructive fraud is a form of strict liability to redress creditor injury."[102] As Baird and Jackson put it, "[a] birthday gift of cash by an insolvent . . . injures creditors just as much when his intentions are innocent as when they are not."[103]

Cases of merely constructive "fraud," therefore, cannot give rise to a nondischargeable debt. Nondischargeability, therefore, can only come into play if the debt at issue arises from a so-called "actual" fraudulent transfer made with "actual intent to hinder, delay, or defraud any creditor" of the transferor. As Judge Posner stated in *McClellan*:

> The distinction between actual and constructive fraud is the key [to nondischargeability]. To transfer property for less than adequate consideration may be desperate, foolish, or imprudent, and the receipt of such a transfer a pure windfall, but neither the transfer nor the receipt is in and of itself dishonest, and so neither is an appropriate ground for refusing to allow the debtor to discharge the debt arising from the transfer and thus to get on with his life without the debt hanging over his head. The situation is entirely different, and the debtor's equities and argument for discharge much weaker, when the debtor is guilty of intent to defraud. The purpose of section 523(a)(2)(A) in confining nondischargeability to *actual* fraud is merely to recognize this difference and thus to exclude constructive fraud. See *Neal v. Clark*, 95 U.S. (5 Otto) 704, 709 (1877) . . . . [W]hen a conveyance is merely constructively fraudulent, in the sense that having transferred the property [at issue] without obtaining adequate consideration the [transferor] is now unable to pay his creditor, the transferee is not guilty of an actual fraud against the creditor and so the creditor cannot use section 523(a)(2)(A) to prevent the transferee from discharging the debt in bankruptcy.[104]

Likewise, in *Husky*, the Supreme Court indicated that the "wrongful intent" necessary to trigger nondischargeability under § 523(a)(2)(A) is "actual intent to hinder, delay, or defraud any creditor" of the transferor.[105] Even in cases of a so-called "actual" fraudulent transfer, though, a transferee's liability will not necessarily, or even generally, be nondischargeable under § 523(a)(2)(A).

Transferee Liability for "Actual" Fraudulent Transfers

In the usual case, fraudulent transfer liability for an "actual" fraudulent transfer has an odd peculiarity regarding the wrongful intent necessary to impose liability on the transferee. "The only inquiry concerning actual intent that matters is that of the [transferor]: whether the [transferor] . . . intended to hinder, delay or defraud its creditor[s]."[106] While it is the transferor's mens rea that ultimately determines whether a transfer is made with "actual intent to hinder, delay, or defraud any creditor" of the transferor, "the [transferor] is not the[ ] target. The remedy is against the transferee; the [transferor] is a mere bystander. It would make little sense to impose liability on the transferee based upon the mental state of a different person, the [transferor]."[107] Thus, modern fraudulent transfer statutes give the transferee of a fraudulent conveyance a good-faith for-value defense, such as the one contained in UFTA § 8(a), which provides that a transfer made "with actual intent to hinder, delay, or defraud any creditor of" the transferor "is not voidable . . . against any person who took in good faith and for a reasonably equivalent value."[108]

Juxtaposing an actual fraudulent transfer against a transferee's good-faith for-value defense reveals that a transferee of an actual fraudulent transfer can have fraudulent conveyance liability even when the transferee does not share the transferor's actual fraudulent intent. This is true with respect to both halves of the good-faith *and* for-value inquiry regarding a transferee's liability. First, even a good-faith transferee is liable if the

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transferee did not give reasonably equivalent value for the transfer (for the amount by which the value of the asset transferred exceeds the value given by the transferee in exchange). Thus, an actually fraudulent transfer made for no consideration (e.g., by way of a gift to a family member), is fully avoidable even if the transferee received the transfer in absolute good faith.

Second, a lack of good faith on the part of a transferee, that likewise renders an actual fraudulent transfer fully avoidable, is a mens rea threshold that falls well below the wrongful intent of the transferor (i) that makes the transfer a *prima facie* actual fraudulent transfer and (ii) that the transferee must share in order to trigger nondischargeability under Code § 523(a)(2)(A). Indeed, in this context, good faith is an objective, inquiry-notice standard. "[C]ourts look to what the transferee objectively 'knew or should have known' in questions of good faith, rather than examining what the transferee actually knew from a subjective standpoint."[109] As the Supreme Court put it in an 1894 decision:

> A statute that declares every transfer of property made with intent to delay or defraud any creditor of his demands void against all creditors of the debtor [is] subject to the rule that "whatever is notice enough to excite attention and put the party on his guard, and call for inquiry, is notice of everything to which such inquiry might have led."[110]
>
> * * * *
>
> [W]hile the plaintiff was not bound to act upon mere suspicion as to the intent with which his brother made the sale in question, if he had knowledge or actual notice of circumstances sufficient to put him, as a prudent man, upon inquiry as to whether his brother intended to delay or defraud his creditors, and he omitted to make such inquiry with reasonable diligence, he should have been deemed to have notice of such fact, and therefore such notice as would invalidate the sale to him, if such sale was in fact made with the intent upon the part of the vendor to delay or defraud other creditors.[111]

Thus, a transferee's liability for an actual fraudulent transfer will often be premised upon a mens rea that does *not* rise to the level of "actual intent to hinder, delay, or defraud any creditor" of the transferor—the wrongful intent necessary to make a debt nondischargeable as one for "actual fraud" under Code § 523(a)(2)(A). In the *Husky* case itself, the potential disconnect between the mens rea of the transferor and that of the transferee does not exist, "because Husky contends that Ritz was both the transferor and the transferee in his fraudulent conveyance scheme, having transferred Chrysalis assets to other companies he controlled."[112] In other cases, though, the transferee may not share the transferor's "actual intent to hinder, delay, or defraud" the transferor's creditors.

Nondischargeability Requires Wrongful Intent by the Debtor-Transferee

A transferee's liability for an actual fraudulent transfer, therefore, can be premised upon divergent *mentes reae* as between transferor and transferee: The transferor made the transfer "with actual intent to hinder, delay, or defraud" the transferor's creditors, but the transferee was merely on inquiry notice of that fraud and did *not* have an "actual intent to hinder, delay, or defraud" the transferor's creditors. Such a situation exposes yet another ambiguity in the language of § 523(a)(2)(A) that has perpetuated a longstanding controversy regarding so-called vicarious nondischargeability.[113]

The language of § 523(a)(2)(A) is ambiguous as to whether the debtor must have engaged in the fraud by which money or property was obtained. Indeed, "nothing in the text of § 523(a)(2)(A) restricts its effects solely to a debt [for money or property] 'obtained by false pretenses, a false representation, or actual fraud' *of the debtor*."[114] A literal reading of § 523(a)(2)(A), therefore, can lead to the conclusion "that debtors cannot discharge any debts that arise from fraud so long as they are liable to the creditor for the fraud."[115]

The notion of vicarious nondischargeability originated in a curious 1885 opinion by Justice Harlan, in the case of *Strang v. Bradner*,[116] which seems altogether inconsistent with his earlier opinion in *Neal v. Clark*. Reconciling those two decisions and, correlatively, deciding whether vicarious nondischargeability has any validity at all and, if so, determining its scope, requires a Herculean endeavor and, ultimately, is not entirely cogent or convincing.[117] Even if *Strang v. Bradner* and vicarious nondischargeability retain some continuing

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vitality, though,[118] the principal liability context implicated by *Husky*—the fraudulent transfer liability of a transferee—nonetheless would seem to be controlled by the *Neil v. Clark* holding. Indeed, in *Husky* the Court indicated that the transferee of a fraudulent transfer must act "with the requisite [wrongful] intent" in order to "also commit[actual] fraud" that would render the transferee's fraudulent conveyance liability nondischargeable. In fact, *Neil v. Clark* itself—the holding of which Congress "intended to codify" with the "actual fraud" discharge exception[119]—addressed precisely such transferee liability for a fraudulent transfer.

In *Neal v. Clark*, the debt at issue arose out of an executor's administration of a decedent's estate. In disposing of the decedent's real property, the executor sold the land on credit, with the purchasers giving the executor secured promissory notes payable to the estate. The executor subsequently sold two of the notes to Neal, at a substantial discount from their face value, indicating to Neal that the proceeds would be used to pay the executor amounts the estate owed the executor. In fact, though, no amounts were owing from the estate to the executor, and the executor simply absconded with the proceeds. Neal subsequently received a discharge in bankruptcy, but was thereafter sued by the executor's sureties in state court on behalf of the decedent's estate, contending (1) that Neal was liable to the estate and its beneficiaries "on the ground of a fraudulent participation with the executor in the commission of a *devastavit* of his testator's estate"[120] and (2) that Neal's debt therefor was a nondischargeable fraud debt.

The *devastavit* action was closely analogous to the conventional fraudulent conveyance remedy, but was an action available to all claimants of the decedent's estate (rather than just creditors) because "in courts of equity, the assets are treated as the debtor, or, in other words, as a trust fund, to be administered by the executor for the benefit of all persons who are interested in it, whether they are creditors or legatees, or distributes, or otherwise interested."[121] A *devastavit*, therefore, was a transfer made by an executor with intent to hinder, delay, or defraud creditors, beneficiaries, and other claimants on the decedent's estate, and whenever there was a *devastavit* by the executor, "and the assets or their proceeds can be traced into the hands of any persons affected with notice of such misapplication, there the trust will attach upon the property or proceeds in the hands of such person."[122]

In *Neal v. Clark*, the state court held, with respect to the notes sold to Neal, that "the executor commit[ted] a *devastavit* by making the sale for the purpose of converting the proceeds to his own use, and by actually so converting them."[123] With respect to Neal, though, as transferee of the notes, the state court found that "[h]e was not guilty of actual fraud in making the purchase; but . . . he was guilty of constructive fraud, which was sufficient to implicate him as a participant in the *devastavit* certainly committed by the executor,"[124] because he was on inquiry notice of the executor's *devastavit*.[125] The Virginia Supreme Court held that this was also sufficient to render Neal's *devastavit* liability a nondischargeable debt for "fraud":

> The [bankruptcy] act does not say 'actual' fraud, or 'moral' fraud; or qualify the word by any other adjective. It uses only the generic word *fraud* . . . . Certainly if the purchaser had actually colluded with the executor to commit a *devastavit*, his fraud would have come within the meaning of the [bankruptcy] act. Why does it not come within the meaning . . . when he has so dealt with the executor . . . as to make him liable for [the executor's fraud]?[126]

The Supreme Court, though, via Justice Harlan's opinion, answered that rhetorical question by rejecting any notion of vicarious nondischargeability "upon the ground of [Neal] having been guilty of an implied or constructive fraud."[127]

> [T]he 'fraud' referred to in that section means positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, . . . and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality.[128]
>
> * * * *
>
> We concur in the view expressed by the State court, that Neal was not guilty of actual fraud. The evidence does not show that he entertained any purpose himself to commit a fraud, or to aid the executor in committing one.[129]
>
> * * * *
>
> It results from what has been said that the debt or claim asserted against Neal was not 'created by the fraud . . . of the bankrupt,' within the meaning of the thirty-third section of the law of 1867. His dis-

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charge in bankruptcy affords him complete protection.[130]

In a previous issue of *Bankruptcy Law Letter*, I analyzed the implications of *Neal v. Clark*, in light of the subsequent *Strang v. Bradner* decision and Congress' codification of the *Neal v. Clark* "actual fraud" standard for nondischargeability in Code § 523(a)(2)(A), and that analysis clearly speaks to the dischargeability of a transferee's liability for an actual fraudulent transfer. Even if vicarious nondischargeability is a legitimate doctrine (of which I am highly skeptical),

> extending the debtor's vicarious liability to vicarious nondischargeability of the liability, under the doctrine of *Strang v. Bradner*, simply buttresses the equitable compensation goals embodied in [a] nonbankruptcy [vicarious] liability scheme. The debtor's liability in *Neal v. Clark*, by contrast, was not based upon a purely vicarious/compensatory liability regime; applicable nonbankruptcy law imposed liability for the executor's fraudulent misconduct on Neal only upon a showing of some level of misconduct by Neal [inquiry notice of the fraud]. Neal's liability, therefore, was at least partially founded upon culpability, and the holding of *Neal v. Clark* is simply that the only level of culpability that gives rise to a nondischargeable debt is "positive fraud . . .involving . . .intentional wrong."
>
> Together, then, *Neal v. Clark* and *Strang v. Bradner* illustrate that . . . when the debtor's liability under applicable nonbankruptcy law is premised upon a system of relative culpability, then the fraud exception's punitive objects are [paramount], reserving nondischargeability solely for those culpability-based debts that rise to the level of actual fraud.[131]

Because a transferee's liability for an actual fraudulent transfer—that the transferor made with actual intent to hinder, delay, or defraud the transferor's creditors—is also triggered by some level of culpability by the transferee, this is another context in which the only level of culpability that can render the transferee's liability nondischargeable is if the transferee "entertained any purpose himself to commit a fraud, or to aid the [transferor] in committing one."[132] Indeed, that was the holding of the Supreme Court in the 1878 decision in *Wolf v. Stix*, in which the Court applied the *Neal v. Clark* decision (from its immediately preceding term) to a transferee's liability for an actual fraudulent transfer.[133]

That insistence that a debt is nondischargeable only if the debtor's liability arises from "an intentional wrong" *by the debtor*, or "reckless conduct of the kind that the criminal law often treats as the equivalent," is "also consistent with a set of statutory [discharge] exceptions that Congress normally confines to circumstances where . . . the presence of fault" is what compels "preserving the debt."[134] The intuitive moral impulse embodied in § 523(a)(2)(A) is that we should *not* give "perpetrators of fraud a fresh start."[135] By the same token, then, if the debtor herself did not commit "actual fraud," her liability should be dischargeable. As Justice Harlan stated in *Neal v. Clark*, "[s]uch a construction of the statute is consonant with equity, and consistent with the object and intention of Congress in enacting a general law by which the honest citizen may be relieved from the burden of hopeless insolvency."[136]

ENDNOTES:

[1]Husky Intern. Electronics, Inc. v. Ritz, 136 S. Ct. 1581, 62 Bankr. Ct. Dec. (CRR) 156 (2016).

[2]Husky, 136 S. Ct. at 1588. See also id. n.2 (quoting debtor's counsel at oral argument: "to be clear, we don't dispute that fraudulent conveyance is a form of actual fraud"); id. at 1590 (Thomas, J., dissenting) ("I do not quibble with the majority's conclusion that the *common-law* definition of 'actual fraud' included fraudulent transfers.").

[3]Husky, 136 S. Ct. at 1588.

[4]Husky, 136 S. Ct. at 1588.

[5]In re Ritz, 459 B.R. 623, 626 (Bankr. S.D. Tex. 2011), decision aff'd, 513 B.R. 510 (S.D. Tex. 2014), aff'd, 787 F.3d 312, 61 Bankr. Ct. Dec. (CRR) 23, Bankr. L. Rep. (CCH) P 82829 (5th Cir. 2015), cert. granted, 136 S. Ct. 445, 193 L. Ed. 2d 346 (2015).

[6]Tex. Bus. Org. Code § 21.223(b) (emphasis added).

[7]Uniform Fraudulent Transfer Act (UFTA) § 4(a)(1).

[8]See In re Ritz, 513 B.R. 510, 535-38 (S.D. Tex. 2014) (relying upon Spring Street Partners-IV, L.P. v. Lam, 730 F.3d 427 (5th Cir. 2013)), aff'd, 787 F.3d 312, 61 Bankr. Ct. Dec. (CRR) 23, Bankr. L. Rep. (CCH) P 82829 (5th Cir. 2015), cert. granted, 136 S. Ct. 445, 193 L. Ed. 2d 346 (2015).

[9]The bankruptcy court stated that "[a]s a result of" Ritz's "orchestration of the fund transfers out of Chrysalis's account," Chrysalis "was drained of all of its cash and, therefore, could not pay its credi-

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tors." 459 B.R. at 626, 628. Nonetheless, the bankruptcy court never made a specific finding that those transfers were made with "actual intent to hinder, delay, or defraud" Chrysalis' creditors. At most, the bankruptcy court's specific findings establish that the transfers were "constructively fraudulent" under UFTA § 5(a), in that they were made when Chrysalis was insolvent *and* Chrysalis did not receive reasonably equivalent value in exchange for any of those transfers.

[10]In re Ritz, 787 F.3d 312, 321, 61 Bankr. Ct. Dec. (CRR) 23, Bankr. L. Rep. (CCH) P 82829 (5th Cir. 2015), cert. granted, 136 S. Ct. 445, 193 L. Ed. 2d 346 (2015).

[11]McClellan v. Cantrell, 217 F.3d 890, 36 Bankr. Ct. Dec. (CRR) 92, 44 Collier Bankr. Cas. 2d (MB) 576, Bankr. L. Rep. (CCH) P 78219, 42 U.C.C. Rep. Serv. 2d 284 (7th Cir. 2000).

[12]In re Lawson, 791 F.3d 214, 61 Bankr. Ct. Dec. (CRR) 92, Bankr. L. Rep. (CCH) P 82845 (1st Cir. 2015).

[13]Husky, 136 S. Ct. at 1586.

[14]Max Radin, Fraudulent Conveyances at Roman Law, 18 Va. L. Rev. 109, 110-11 (1931). See also Kenneth C. Kettering, The Uniform Voidable Transactions Act: or, the 2014 Amendments to the Uniform Fraudulent Transfer Act, 70 Bus. Law. 777, 807 (2015); Jay Adkisson, The Uniform Voidable Transactions Act—What's With the Name Change?, Forbes Personal Finance (July 18, 2014), at http://www.forbes.com/sites/jayadkisson/2014/07/18/the-uniform-voidable-transactions-act-whats-with-the-name-change/#e0d5e6b8f633.

[15]Radin, 18 Va. L. Rev. at 111.

[16]Id. at 111.

[17]See Radin, 18 Va. L. Rev. at 129 (translating Digest of Justinian, Book 50, tit. 17, "A Collection of Ancient Legal Rules," § 79, Papinian's Questions, Book 32) ("In our law, in interpreting the word 'fraud' we always require an intentional element and do not merely apply it to acts which have a prejudicial result."); Frank R. Kennedy, Involuntary Fraudulent Transfers, 9 Cardozo L. Rev. 531, 535 (1987) ("The Roman law, like so much of the Anglo-American law of fraudulent transfers, purported to be concerned only with dispositions that were intentionally fraudulent. Knowledge that creditors would suffer was considered sufficient, however.").

[18]Radin, 18 Va. L. Rev. at 111.

[19]Max Radin, Fraudulent Conveyances in California and the Uniform Fraudulent Conveyance Act, 27 Cal. L. Rev. 1, 1 (1938).

[20]As Professor Glenn noted, "[t]he very terms, 'in fraud of creditors,' and 'with intent to defraud' them, as appearing in Roman law, found their way, with monotonous regularity, into English statutes long before the Act of Elizabeth was drafted." 1 Garrard Glenn, Fraudulent Conveyances and Preferences § 60, at 83 (rev. ed. 1940) (footnote omitted). See also Kennedy, 9 Cardozo L. Rev. at 536 & n.16 (citing "English legislation directed at such transfers [that] had been enacted by Parliament during the preceding two centuries"); Radin, 27 Cal. L. Rev. at 1-2 (noting that the 1571 Statute of 13 Elizabeth "reenacted many of the provisions and repeated many of the words of statutes of Henry VIII and Edward III").

Indeed, "[i]t has often been stated, the authorship being traceable to no less an authority than Lord Mansfield, that even if this statute had not been passed, creditors could have obtained the same relief at common law." 1 Glenn, Fraudulent Conveyances, § 59, at 81 & n.8 (and discussing a 1477 chancery case nicely illustrating "that the equity courts could have worked out a doctrine in behalf of creditors"). See Sumner v. Hicks, 67 U.S. 532, 534, 17 L. Ed. 355, 1862 WL 6743 (1862) ("The Statute of Elizabeth was declaratory of the common law."); Cadogan v. Kennett, 98 Eng. Rep. 1171, 1172 (K.B. 1776) (Mansfield, L.J.) ("The principles and rules of the common law, as now universally known and understood, are so strong against fraud in every shape, that the common law would have attained every end proposed by the statute[] 13 El. c.5."). Moreover, from the very beginning, certain aspects of fraudulent conveyance law developed independently of the Statute of Elizabeth. Even after that codification, then, "the law of fraudulent conveyances was a mosaic of statutes and decisions, which had been developed around the Statute of Elizabeth." 1 Glenn, Fraudulent Conveyances, § 58, at 80-81. That mosaic was replicated and propagated in the American colonies and states in their statutory enactments and common law, and it remained as such until the first uniform act, the Uniform Fraudulent Conveyance Act (UFCA) promulgated in 1918, was widely enacted by the states. See id. at 79-81; Peters v. Bain, 133 U.S. 670, 685, 10 S. Ct. 354, 33 L. Ed. 696 (1890) (noting that the English law "against fraudulent conveyances" developed under the Statute of Elizabeth "has been universally adopted in American law as the basis of our jurisprudence on that subject").

[21]13 Eliz., ch.5, § I (1571), reprinted in 2 Glenn, Fraudulent Conveyances, at 1069.

[22]See Boston Trading Group, Inc. v. Burnazos, 835 F.2d 1504, 1507-11 (1st Cir. 1987) (Breyer, C.J.).

[23]Restatement (Second) of Torts § 525 (1977).

[24]Boston Trading Group, 835 F.3d at 1517 (some emphasis in original and some emphasis added).

[25]Husky, 136 S. Ct. at 1587 (emphasis added).

[26]Thomas Jackson, Avoiding Powers in Bankruptcy, 36 Stan. L. Rev. 725, 778 (1984).

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[27]In re Sharp Intern. Corp., 403 F.3d 43, 55-56, 44 Bankr. Ct. Dec. (CRR) 146 (2d Cir. 2005).

[28]Husky, 136 S. Ct. at 1587.

[29]The Official Comments explain that "[n]either the retitling of the Act, nor the consistent use of 'voidable' in its text [in lieu of 'fraudulent'] effects any change in the meaning of the Act." UVTA § 15, official comment 5. As of this writing, nine states have enacted the UVTA, and legislative bills proposing enactment of the UVTA have been introduced in an additional seven states.

[30]"Such a transaction need not bear any resemblance to common-law fraud," and "[t]he elements of a claim for relief [for 'actual intent to hinder, delay, or defraud' creditors] are very different from the elements of a claim of common-law fraud[ulent]" inducement by misrepresentation. UVTA § 4, official comments 8 & 10.

[31]S. Rep. No. 95-989, at 78 (1978) (emphasis added); H.R. Rep. No. 95-595, at 364 (1977) (emphasis added).

[32]Bankruptcy Act of 1898, § 17a(2).

[33]Husky, 136 S. Ct. at 1586.

[34]In *Field v. Mans*, the Court stated that "[t]he operative terms in § 523(a)(2)(A), . . . 'false pretenses, a false representation, or actual fraud,' . . . imply the elements that the common law has defined them to include" and "look[ed] to the concept of 'actual fraud' as it was understood in 1978 when that language was added to § 523(a)(2)(A)," which the Court "construe[d] . . . to incorporate the general common law of torts." 516 U.S. 59, 69-70 & n.9 (1995). "Then, as now, the most widely accepted distillation of the common law of torts was the Restatement (Second) of Torts (1976), published shortly before Congress passed the" Bankruptcy Reform Act of 1978. Id. at 70. Because that case involved an allegation of a nondischargeable debt procured by misrepresentation, the Court looked to "[t]he [Restatement] section on point dealing with fraudulent misrepresentation." Id. The *Husky* majority, though, took that reference to the common law of torts as precedential "only in setting forth the requirements of the form of fraud alleged in that case—namely, fraud perpetrated through a misrepresentation to a creditor." Husky, 136 S. Ct. at 1589.

[35]See Restatement (Second) of Torts ch. 22, topic 1 (titled "Fraudulent Misrepresentation (Deceit)").

[36]See Restatement (Second) of Torts §§ 550-551. Significantly, those circumstances go well *beyond* a fiduciary's fraud liability for nondisclosure, which seems to be more specifically addressed via Code § 523(a)(4)'s discharge exception for "any debt for fraud . . . while acting in a fiduciary capacity."

[37]See 3 Wayne R. LaFave, Substantive Criminal Law § 19.7(b)(3), at 116-17 (2d ed. 2003); Model Penal Code § 223.3 (1980).

[38]"[T]he modern crime of obtaining property by false pretenses (often called by the shorter term 'false pretenses') was created by Parliament in 1757," and "[m]ost American states enacted a statute similar to the original English statute." 3 LaFave, Substantive Criminal Law, § 19.7(a), at 114. See generally id. § 19.1(b), at 60-61; Model Penal Code § 223.1, comment 2(a), at 129-30.

[39]Restatement (Second) of Torts § 551(1) (emphasis added). See also id. § 550. One is reminded of Abraham Lincoln's famous story that he related to express his doubts regarding the linguistic gymnastics surrounding the Emancipation Proclamation: "In discussing the question, he used to liken the case to that of the boy who, when asked how many legs his calf would have if he called its tail a leg, replied, 'Five,' to which the prompt response was made that *calling* the tail a leg would not *make* it a leg." Reminiscences of Abraham Lincoln by Distinguished Men of His Time 241 (Allen Thorndike Rice ed. 1909) (as told by George W. Julian).

[40]See Bullock v. BankChampaign, N.A., 133 S. Ct. 1754, 1760, 185 L. Ed. 2d 922, 57 Bankr. Ct. Dec. (CRR) 265, 69 Collier Bankr. Cas. 2d (MB) 456, Bankr. L. Rep. (CCH) P 82481 (2013) (stating that " '[f]raud' typically requires a false statement *or omission*," including "fraud in the context of false pretenses" (emphasis added)).

[41]Husky, 136 S. Ct. at 1586.

[42]Husky, 136 S. Ct. at 1586.

[43]"The operative terms in § 523(a)(2)(A), . . . 'false pretenses, a false representation, or actual fraud,' carry the acquired meaning of terms of art" as "common-law terms," and "there is no reason to doubt Congress's intent to adopt a common-law understanding of the terms it used" in Code § 523(a)(2)(A). Field v. Mans, 516 U.S. at 69-70.

[44]Kenneth C. Kettering, Securitization and Its Discontents: The Dynamics of Financial Product Development, 29 Cardozo L. Rev. 1553, 1586 (2008). Kettering was the Reporter for the 2014 UVTA.

[45]See Twyne's Case, 3 Coke Rep. 80b, 76 Eng. Rep. 809, 823 (Star Chamber 1601) (reporting as "the judgment of the whole Court" that "Twyne was convicted of fraud"); 13 Eliz., ch. 5, § III (providing that "all and every the parties to such feigned, covinous, or fraudulent . . . conveyance . . . before expressed, and being privy and knowing of the same . . . and also being thereof lawfully convicted, shall suffer imprisonment for one-half year without bail or mainprise").

[46]5 Collier on Bankruptcy ¶ 548.01[2][d], at 548-24.1 (16th ed. 2016) (citing state statutes).

[47]See Model Penal Code art. 224; id. § 224.10 & comment 4; id. § 224.11(1).

[48]Husky, 136 S. Ct. at 1586.

[49]Husky, 136 S. Ct. at 1593 (Thomas, J., dis-

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senting) (quoting 4 Collier (16th ed.) ¶ 523.08[1][e], at 523-46).

[50]Husky, 136 S. Ct. at 1590 (Thomas, J., dissenting).

[51]Husky, 136 S. Ct. at 1591 (Thomas, J., dissenting).

[52]Husky, 136 S. Ct. at 1591 (Thomas, J., dissenting).

[53]Ritz, 787 F.3d at 321.

[54]See Archer v. Warner, 538 U.S. 314, 123 S. Ct. 1462, 155 L. Ed. 2d 454, 41 Bankr. Ct. Dec. (CRR) 12, 49 Collier Bankr. Cas. 2d (MB) 1019, Bankr. L. Rep. (CCH) P 78821 (2003); Cohen v. de la Cruz, 523 U.S. 213, 118 S. Ct. 1212, 140 L. Ed. 2d 341, 32 Bankr. Ct. Dec. (CRR) 400, 38 Collier Bankr. Cas. 2d (MB) 1891, Bankr. L. Rep. (CCH) P 77644 (1998); Grogan v. Garner, 498 U.S. 279, 111 S. Ct. 654, 112 L. Ed. 2d 755, 21 Bankr. Ct. Dec. (CRR) 342, 24 Collier Bankr. Cas. 2d (MB) 1, Bankr. L. Rep. (CCH) P 73746A, 70 A.F.T.R.2d 92-5639 (1991); Brown v. Felsen, 442 U.S. 127, 99 S. Ct. 2205, 60 L. Ed. 2d 767, 5 Bankr. Ct. Dec. (CRR) 226, 20 C.B.C. 273, 1 Collier Bankr. Cas. 2d (MB) 34, Bankr. L. Rep. (CCH) P 67122 (1979).

[55]Cohen v. de la Cruz, 523 U.S. at 223.

[56]Grogan v. Garner, 498 U.S. at 287.

[57]Archer v. Warner, 538 U.S. at 321 (quoting Brown v. Felsen, 442 U.S. at 138).

[58]Cohen v. de la Cruz, 523 U.S. at 223 (quoting Grogan v. Garner, 498 U.S. at 287).

[59]Husky, 136 S. Ct. at 1591-92 (Thomas, J., dissenting).

[60]Husky, 136 S. Ct. at 1589.

[61]McClellan, 217 F.3d at 894-95.

[62]Cohen v. de la Cruz, 523 U.S. at 218.

[63]Cohen v. de la Cruz, 523 U.S. at 218-19.

[64]Cohen v. de la Cruz, 523 U.S. at 218 (emphasis added).

[65]Cohen v. de la Cruz, 523 U.S. at 215.

[66]Cohen v. de la Cruz, 523 U.S. at 218 (quoting Field v. Mans, 523 U.S. at 61, 64).

[67]Husky, 136 S. Ct. at 1589 (citations omitted).

[68]Grogan v. Garner, 498 U.S. at 287.

[69]McClellan, 217 F.3d at 893.

[70]Grogan v. Garner, 498 U.S. at 287.

[71]Cohen v. de la Cruz, 523 U.S. at 218 (emphasis added).

[72]See Husky, 136 S. Ct. at 1589 n.3.

[73]In re Bilzerian, 100 F.3d 886, 890, 30 Bankr. Ct. Dec. (CRR) 4, 37 Collier Bankr. Cas. 2d (MB) 234, Bankr. L. Rep. (CCH) P 77182 (11th Cir. 1996).

[74]Blizerian, 100 F.3d at 890.

[75]Bilzerian, 100 F.3d at 890.

[76]Bilzerian, 100 F.3d at 890. See In re Leonard, 2016 WL 1178649, at *7 (6th Cir. 2016); In re Brady, 101 F.3d 1165, 1171-72, 30 Bankr. Ct. Dec. (CRR) 15, 37 Collier Bankr. Cas. 2d (MB) 218, Bankr. L. Rep. (CCH) P 77202, 1996 FED App. 0379P (6th Cir. 1996); Bilzerian, 100 F.3d at 889-91; In re Arm, 87 F.3d 1046, 1049, 36 Collier Bankr. Cas. 2d (MB) 293 (9th Cir. 1996); In re Pryor, 992 F.2d 324, 1993 WL 152116, at *2 (5th Cir. 1993) (unpublished table decision); In re Ashley, 903 F.2d 599, 604, 20 Bankr. Ct. Dec. (CRR) 344, 23 Collier Bankr. Cas. 2d (MB) 176, Bankr. L. Rep. (CCH) P 73230 (9th Cir. 1990); In re Gerlach, 897 F.2d 1048, 1050 n.1, 22 Collier Bankr. Cas. 2d (MB) 1101, Bankr. L. Rep. (CCH) P 73280 (10th Cir. 1990).

[77]See, e.g., Chu v. Hong, 249 S.W.3d 441, 444 (Tex. 2008); Summers v. Hagen, 852 P.2d 1165, 1169-70 (Alaska 1993) (en banc); McElhanon v. Hing, 151 Ariz. 403, 728 P.2d 273, 278 (1986) (en banc); Croxson v. Croxson, 130 Cal. App. 2d 50, 277 P.2d 864, 871 (2d Dist. 1954); In re Restaurant Development Group, Inc., 397 B.R. 891, 896-97, 50 Bankr. Ct. Dec. (CRR) 97 (Bankr. N.D. Ill. 2008) (Illinois law).

[78]See, e.g., Restaurant Dev. Group, 397 B.R. at 897-98 (Illinois law); Bondi v. Citigroup, Inc., 2005 WL 975856, at * 20 (N.J. Super. Ct. Law Div. 2005).

[79]Archer v. Warner, 538 U.S. at 321 (quoting Brown v. Felsen, 442 U.S. at 138).

[80]Bullock, 133 S. Ct. at 1761.

[81]124 Cong. Rec. 33,998 (1978) (statement of Sen. DeConcini); 124 Cong. Rec. 32,399 (1977) (statement of Rep. Edwards).

[82]Bankruptcy Act of 1867, § 33.

[83]Neal v. Clark, 95 U.S. 704, 709, 24 L. Ed. 586, 1877 WL 18562 (1877).

[84]By stating "that the statutory term 'defalcation' [in Code § 523(a)(4)] should be treated similarly" to the term "fraud" as construed in *Neal v. Clark*. Bullock, 133 S. Ct. at 1759.

[85]Bullock, 133 S. Ct. at 1759.

[86]Husky, 136 S. Ct. at 1586, 1589.

[87]Husky, 136 S. Ct. at 1586 (citing *Neal v. Clark*).

[88]Neal v. Clark, 95 U.S. (5 Otto) at 707.

[89]Radin, 18 Va. L. Rev. at 111.

[90]Bruce A. Markell, Following Zaretsky: Fraudulent Transfers and Unfair Risk, 75 Am. Bankr. L.J. 317, 320 (2001). Markell is the author of the fraudulent transfer chapter of the current edition of Collier on Bankruptcy. See 5 Collier (16th ed.) ¶ 548.

[91]See generally John C. McCoid, Constructively Fraudulent Conveyances: Transfers for Inadequate

Consideration, 62 Tex. L. Rev. 639 (1983).

[92]See Reade v. Livingston, 3 Johns. Ch. 481 (N.Y. 1818) (gift transfer); Boyd & Suydam v. Dunlap, 1 Johns. Ch. 478 (N.Y. 1815) (transfers for inadequate consideration). The case law regarding gift transfers originated in England around the middle of the eighteenth century. See 1 Glenn, Fraudulent Conveyances, § 268, at 446; Kennedy, 9 Cardozo L. Rev. at 538.

[93]McCoid, 62 Tex. L. Rev. at 650.

[94]Boyd & Suydam v. Dunlap, 1 Johns. Ch. at 482.

[95]See, e.g., Douglas G. Baird & Thomas H. Jackson, Fraudulent Conveyance Law and Its Proper Domain, 38 Vand. L. Rev. 829, 831 n.12 (1985) ("A person who wishes to be generous to a relative or friend does not necessarily have a bad state of mind toward creditors.").

[96]This aspect of *Reade v. Livingston*, allowing avoidance of any gift by a then-existing creditor who ultimately is not paid, eventually fell into disfavor as overly aggressive and gave way to the financial-vulnerability tests that now appear in Bankruptcy Code § 548(a)(1)(B)(ii)(I)-(III).

[97]The Bankruptcy Code entirely abolishes the distinction between existing and future creditors in actions under § 548(a)(1), and pursuant to the doctrine of *Moore v. Bay*, 284 U.S. 4 (1931), partially abolishes the distinction in state-law fraudulent transfer actions under § 544(b)(1).

[98]Reade v. Livingston, 3 Johns. Ch. at 505.

[99]Markell, 75 Am. Bankr. L.J. at 321.

[100]McCoid, 62 Tex. L. Rev. at 656.

[101]Robert Charles Clark, The Duties of the Corporate Debtor to its Creditors, 90 Harv. L. Rev. 505, 510 (1977).

[102]Charles J. Tabb & Ralph Brubaker, Bankruptcy Law: Principles, Policies, and Practice 499 (4th ed. 2015).

[103]Baird & Jackson, 38 Vand. L. Rev. at 832.

[104]McClellan, 217 F.3d at 894.

[105]See Husky, 136 S. Ct. at 1589 (citing *McClellan* and the *Husky* Court's own discussion of "actual intent to hinder, delay, or defraud" in reference to "the requisite intent" for nondischargeability).

[106]5 Collier (16th ed.) ¶ 548.04[2], at 548-63.

[107]Kettering, 70 Bus. Law. at 809.

[108]UFTA §§ 4(a)(1), 8(a). See also UVTA § 8(a); UFCA § 9; 11 U.S.C.A. § 548(c).

[109]In re Agricultural Research and Technology Group, Inc., 916 F.2d 528, 535-36, 23 Collier Bankr. Cas. 2d (MB) 1517, Bankr. L. Rep. (CCH) P 73652 (9th Cir. 1990).

[110]Shauer v. Alterton, 151 U.S. 607, 621 (1894) (quoting Wood v. Carpenter, 101 U.S. (11 Otto) 135, 141 (1879)).

[111]Shauer v. Alterton, 151 U.S. at 621.

[112]Husky, 136 S. Ct. at 1589 n.3. Control of a corporation is sufficient to impute an actor's fraudulent intent to the corporation. See 5 Collier (16th ed.) ¶ 548.04[1][a][iv], at 548-62.

[113]See generally Ralph Brubaker, Fresh Start, Vicarious Liability, and the Fraud and Malice Discharge Exceptions: Punishment vs. Compensation—State Law vs. Federal Law, 21 Bankr. L. Letter No. 5, at 1 (May 2001); Ralph Brubaker, The Dischargeability of "Control Person" Liability for Federal Securities Fraud: Actual Fraud, Vicarious Nondischargeability, and the Vacillating Objects of the § 523(a)(2)(A) Discharge Exception, 22 Bankr. L. Letter No. 5, at 5 (May 2002); Lawrence Ponoroff, Vicarious Thrills: The Case for the Application of Agency Rules in Bankruptcy Dischargeability Litigation, 70 Tulane L. Rev. 2515 (1996); Steven H. Resnicoff, Is It Morally Wrong to Depend on the Honesty of Your Partner or Spouse?: Bankruptcy Dischargeability of Vicarious Debt, 42 Case W. Res. L. Rev. 147 (1992).

[114]Brubaker, 22 Bankr. L. Letter No. 5, at 5 (emphasis added).

[115]In re M.M. Winkler & Associates, 239 F.3d 746, 749, 37 Bankr. Ct. Dec. (CRR) 95, Bankr. L. Rep. (CCH) P 78350 (5th Cir. 2001).

[116]Strang v. Bradner, 114 U.S. 555, 5 S. Ct. 1038, 29 L. Ed. 248 (1885).

[117]See Brubaker, 22 Bankr. L. Letter No. 5, at 8-10. To reconcile those decisions, one must accept the idea that "the fraud exception to discharge can and does vindicate *both* compensatory *and* punitive objects, and the means by which it determines the relevant objective in a particular case is through the federalism principle implicit in *both* opinions: deference to the policies embodied in applicable nonbankruptcy liability rules." Id. at 10. Personally, though, I believe that the exclusive touchstone of the discharge exception for fraud debts "is serious debtor culpability and, thus, there is no [legitimate] reason to withhold discharge of the obligation of a wholly innocent (and only vicariously liable) debtor." Heidi M. Hurd & Ralph Brubaker, The Virtue of Bankruptcy (Oxford Univ. Press forthcoming).

[118]The most plausible means by which to reconcile *Strang v. Bradner* with *Neal v. Clark*, see supra note 117, limits *Strang v. Bradner* to cases of purely vicarious liability that require no showing whatsoever of any fault by the vicariously liable debtor: "Where the debtor's liability under applicable nonbankruptcy law is premised upon a purely vicarious/compensatory liability design, then the fraud exception (in deference to nonbankruptcy liability policy) is also purely compensatory, rendering a debtor's purely vicarious fraud debt nondis-

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chargeable." Brubaker, 22 Bankr. L. Letter No. 5, at 10.

[119]124 Cong. Rec. 33,998 (1978) (statement of Sen. DeConcini); 124 Cong. Rec. 32,399 (1977) (statement of Rep. Edwards).

[120]Neal v. Clark, 95 U.S. (5 Otto) at 706.

[121]Joseph Story, Commentaries on Equity Jurisprudence as Administered in England and America § 579, at 565 (Jairus W. Perry ed., 12th ed. 1877). See id. §§ 579-581; Everingham v. Vanderbilt, 51 How. Pr. 177, 182-83, 1876 WL 11155 (N.Y. Gen. Term 1876).

[122]Story, Equity Jurisprudence, § 581, at 567.

[123]Jones' Ex'rs v. Clark, 66 Va. 642, 645, 25 Gratt. 642, 1875 WL 258 (1875), rev'd, 95 U.S. 704, 24 L. Ed. 586, 1877 WL 18562 (1877).

[124]Jones v. Clark, 66 Va. at 662-63.

[125]As explained by the Virginia Supreme Court:

> The [note] was payable to the executor in that character, which gave express notice to the purchaser that it belonged . . . to the testator's estate; and he bought it from the executor at a discount of eighteen percent. . . . If he had made enquiry before he made the purchase, he could easily have ascertained that the sale would be . . . a *devastavit* by the executor. He ought to have made such enquiry, but he did not do it.

Jones v. Clark, 66 Va. at 663.

[126]Jones v. Clark, 66 Va. at 666-67.

[127]Jones v. Clark, 66 Va. at 667.

[128]Neil v. Clark, 95 U.S. (5 Otto) at 709.

[129]Neil v. Clark, 95 U.S. (5 Otto) at 707.

[130]Neil v. Clark, 95 U.S. (5 Otto) at 709.

[131]Brubaker, 22 Bankr. L. Letter No. 5, at 9-10 (citation omitted)

[132]Neal v. Clark, 95 U.S. (5 Otto) at 707.

[133]In that case, the Court stated:

> In *Neal* v. *Clark* (95 U. S. 704) it was decided that "fraud," as used in this section of the bankrupt law, "means positive fraud or fraud in fact, involving moral turpitude or intentional wrong, . . . and not implied fraud or fraud in law, which may exist without imputation of bad faith or immorality." With this definition we are content. It is founded both on reason and authority. Clearly it does not include such fraud as the law implies from the purchase of property from a debtor with the intent thereby to hinder and delay his creditors in the collection of their debts.

Wolf v. Stix, 99 U.S. 1, 7 (1878).

[134]Bullock, 133 S. Ct. at 1759, 1761.

[135]Grogan v. Garner, 498 U.S. at 287.

[136]Neal v. Clark, 95 U.S. (5 Otto) at 709.

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