

The Fourteenth Annual

Chief Judge Conrad B. Duberstein

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No. 05-628

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 2005

In the Matter of Acme Chemical Industrial Products, Inc., Debtor

Acme Chemical Industrial Products, Inc.,

Petitioner,

v.

Jean Tien,

Respondent.

Fact Pattern

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Jean Tien,

Respondent.

December 10, 2005

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRTEENTH CIRCUIT IS GRANTED, LIMITED TO CONSIDERATION OF THE FOLLOWING QUESTIONS:

1. Whether the equitable powers of the federal courts include the power to order the remedy of substantive consolidation of debtor estates under the Bankruptcy Code.
2. Whether the power to sell assets free and clear of interests under § 363(f) of the Bankruptcy Code permits a sale free and clear of successor liability claims.

**UNITED STATES COURT OF APPEALS
FOR THE THIRTEENTH CIRCUIT**

**IN THE MATTER OF ACME CHEMICAL
INDUSTRIAL PRODUCTS, INC., DEBTOR**

Case No. 05-4080

Jean Tien,

Appellant,

v.

Acme Chemical Industrial Products, Inc.,

Appellee.

Decided: October 17, 2005

Before Judges McDONALD, SCHMID, and TONETTI

McDONALD, Circuit Judge, for the Court.

The present appeal requires the Court to consider the following two issues: 1) whether we have the authority to order the remedy of substantive consolidation under the Bankruptcy Code; and 2) whether a debtor has the ability to sell its assets free and clear of successor liability claims under § 363(f) of the Bankruptcy Code.

I. Factual Background and Procedural History

Acme Chemical Industrial Products, Inc. (hereinafter “ACME”), together with its subsidiaries, is a leading producer and distributor of soda ash and calcium chloride in North America, South America, Southeast Asia, and Europe. ACME primarily serves as the marketer

and distributor of soda ash and calcium chloride while its two wholly-owned subsidiaries, Trona Ash Products Company, Inc. (hereinafter “TAPCO”) and Chemical America Product Company, Inc. (hereinafter “CAPCO”), serve as the producers of soda ash and calcium chloride, respectively. All three companies are incorporated in the State of Kelly.

Soda ash, also known as sodium carbonate (Na_2CO_3), is made both by the processing of the minerals trona ($\text{Na}_3\text{H}(\text{CO}_3)_2\cdot 2\text{H}_2\text{O}$) and nahcolite (NaHCO_3), and by processing sodium carbonate-rich waters called “brines.” Sodium carbonate is one of the most important compounds in the chemical industry. Soda ash is used to make glass, a variety of chemicals, soaps and detergents, synthetic rubber, and explosives. Its uses include the removal of sulfur from smokestack emissions, paper and paper pulp production, water treatment, and oil refining. There are only six companies in the United States that produce soda ash, including ACME. Combined, these companies produce over 14 million tons of soda ash annually. The largest trona deposit in the world is located in the Green River Basin in the State of Wyoming.

Calcium chloride, or CaCl_2 , naturally absorbs moisture from the air, assumes a dissolved state resistant to evaporation, migrates minimally in soil, and produces an exothermic reaction, thereby giving off heat as it melts. Calcium chloride is available in flake, pellet, or liquid form. Based upon these properties, calcium chloride has primarily been utilized as a “de-icing” product for roads and highways throughout the United States. In addition to serving as a “de-icing” agent, the application of calcium chloride to driving surfaces promotes road stabilization by binding the roadway “aggregate,” thereby keeping the road surface dense and compacted. The stabilization to roadways increases load-bearing capacity and promotes resistance to potholing and other forms of surface deterioration. Calcium chloride also can be used as a dehumidifying

agent, and as an “accelerator” in various industries to increase the rate of cement hydration.

ACME manages its subsidiaries’ production and processing of soda ash and calcium chloride in the United States, and serves as a global distributor of soda ash and calcium chloride. ACME is the sole customer of the soda ash and calcium chloride produced by its two subsidiaries. ACME purchases the entire output of its subsidiaries and in turn sells these products to its commercial customers throughout the world. The soda ash distributed by ACME is produced at a facility located in Green River, Wyoming that is owned and operated by TAPCO. The calcium chloride distributed by ACME is produced at a facility located in Manistee, Michigan that is owned and operated by CAPCO. ACME has the overall responsibility for managing the daily operations of both subsidiaries, including operational, sales, marketing and financial matters. All three companies use a centralized cash management system that is operated by ACME. TAPCO and CAPCO share the same corporate officers and board of directors and the members of the senior management teams of both subsidiaries are employees of ACME. Further, several members of the board of directors for both TAPCO and CAPCO also serve on the board of directors for ACME. The prices ACME pays for product purchased from TAPCO and CAPCO are set annually by the CEOs of the respective companies, but do not always reflect current market prices. ACME also assesses administrative charges against both subsidiaries for the management services it performs that also do not always reflect the true value of those services.

Increased industrial development and modernization throughout Southeast Asia and South America during the past ten years, and the continued expansion of the infrastructures in the countries located throughout these regions, have resulted in increased demand for calcium

chloride. Consequently, ACME and CAPCO have realized increased sales during the past several years. The companies, however, are not without problems. Two years ago, several female employees of CAPCO, including the Appellant in the instant appeal, Jean Tien, filed a class action suit against CAPCO in the District Court of Kelly pursuant to Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e *et seq.*, and the Equal Pay Act of 1963, 29 U.S.C. § 206(d), *et seq.*, alleging sex and gender discrimination. The lawsuit asserts that CAPCO created a hostile work environment with respect to its female employees and also failed to pay them “equal pay” for “equal work.” At the time of the bankruptcy filings, the lawsuit remained pending, but if the discrimination plaintiffs prevail their recoveries will be substantial.

Over the course of the past two years, the coalescence of two other events has adversely affected the financial strength of ACME and its two subsidiaries. First, the average United States soda ash prices have fallen from \$110 per ton in June of 2003 to \$75 per ton in the third quarter of 2004 due to reduced demand in the United States. Reliable market forecasts predict that the domestic price of soda ash could plummet to \$60 per ton by the second quarter of 2006. Second, the increased cost of energy, particularly oil and gas prices, within the continental United States has caused the production costs for both soda ash and calcium chloride to skyrocket. As a result, ACME and TAPCO have realized minimal, if any, profit from soda ash production and distribution during the past few years. Profits on ACME’s production and distribution of calcium chloride, however, remain strong.

As a result of the depressed soda ash prices within the United States and increased energy costs, ACME defaulted on its primary credit facility with Giantbank, N.A. This initial default in the credit agreement with Giantbank, N.A., in turn caused a cross-default in ACME’s other

existing credit facilities. Pursuant to the terms of ACME's various lending agreements, the Company's lenders declared all of the credit agreements to be in default and accelerated the amounts due and owing by ACME. ACME currently owes its various lenders well in excess of \$700 million. ACME determined that the continuing viability of its business required a restructuring. To that end, ACME engaged in discussions with its various lenders to accomplish an agreed-upon, out-of-court restructuring. After vigorous negotiations, however, ACME decided that the best mechanism to achieve a restructuring of its indebtedness was to file for relief under Chapter 11 of the Bankruptcy Code.

On August 20, 2004, ACME and its two subsidiaries filed petitions under Chapter 11 of the Bankruptcy Code in the District of Kelly, the state of their incorporation. The next day, the Bankruptcy Court administratively consolidated the bankruptcy estates of ACME, TAPCO, and CAPCO.

After experiencing continuing losses during the early months of the bankruptcy, the Debtors determined that the best course of action was to sell the businesses. Following a vigorous marketing effort, the highest offer was received by Sousa Industries, Inc. (hereinafter "SOUSA"). Because of the manner in which the businesses had been operated, SOUSA insisted on purchasing all of the assets of all three companies "as a unit" and insisted that the sale be structured to insulate it from any successor liability for the potential gender discrimination and equal pay claims asserted in the pending lawsuit against CAPCO. In order to accomplish the sale, on December 20, 2004, ACME filed a motion with the Bankruptcy Court requesting that the Bankruptcy Court substantively consolidate its bankruptcy estate with the bankruptcy estates of TAPCO and CAPCO. In the same motion, ACME requested that the Bankruptcy Court

authorize the sale of substantially all of the assets of ACME, TAPCO and CAPCO to SOUSA free and clear of all liens, claims, and encumbrances, including the CAPCO claims raised in the pending litigation, pursuant to § 363(f) of the Bankruptcy Code.

Several of the named plaintiffs in the CAPCO discrimination lawsuit, including Jean Tien, filed objections to ACME's motion. In addition, the discrimination plaintiffs filed a motion with the Honorable Kristopher Villarreal of the United States District Court for the District of Kelly pursuant to 28 U.S.C. § 157(d) seeking to withdraw the reference of the ACME, TAPCO and CAPCO's bankruptcy cases from the Bankruptcy Court. By order and decision dated January 6, 2005, the District Court granted the discrimination plaintiffs' motion and withdrew the reference to the Bankruptcy Court with respect to the bankruptcy estates of ACME, TAPCO, and CAPCO, noting that the District Court was the more appropriate forum to address any issues of successor liability under federal law and the need to protect and preserve the various discrimination plaintiffs' rights to jury trial under federal law. *See* 28 U.S.C. § 157(e) (West 2005).

On February 9, 2005, the District Court heard testimony and oral argument with respect to ACME's motions to i) substantively consolidate its bankruptcy estate with the bankruptcy estates of TAPCO and CAPCO, and to ii) authorize the sale of assets free and clear of all interests, liens, claims and encumbrances under § 363(f) of the Bankruptcy Code. By order and decision dated March 14, 2005, the District Court granted ACME's motion in its entirety.

In support of its decision, the District Court found that ACME, TAPCO, and CAPCO routinely participated in complex inter-company loans and transactions in their day-to-day business operations, and these transactions were poorly documented and accounted for. The

District Court noted that it would be prohibitively expensive to unravel all of the inter-corporate dealings and determine the true state of affairs of each company. It would be virtually impossible to apportion the sale proceeds between the companies in any principled manner. Further, while the three companies recognized basic corporate formalities, the numerous trade creditors of ACME, TAPCO and CAPCO did not rely upon the independence of the companies when extending credit, but rather treated the three companies as a single unit. While ACME marketed and distributed the soda ash produced by TAPCO and the calcium chloride produced by CAPCO, trade creditors often believed they were dealing with ACME rather than one of its subsidiaries. That is, ACME customarily guaranteed, and often paid, the trade debt owed by TAPCO and CAPCO.

SOUSA is a competitor of TAPCO in the soda ash industry. Its CEO, Michael Sousa, testified that despite the downturn in the soda ash industry in recent years, he expected the market to improve in the near future as a result of newly tightened state and federal environmental regulations affecting businesses engaged in industries utilizing hazardous chemicals. He predicted a significant upswing in the demand for soda ash to help remove sulfur from production facilities. In addition, he testified that the purchase of the CAPCO calcium chloride operations would complement SOUSA's existing product lines. Consequently, SOUSA offered to purchase the businesses for a price slightly above fair market value of the assets. With the exception of directors and officers, SOUSA intends to retain the majority of the three companies' labor forces, and plans to continue operations undisturbed. The asset purchase agreement is conditioned upon the entry of a final non-appealable order holding the sale to be free and clear of the discrimination claims. Thus, SOUSA has refused to consummate the sale

until this appeal is finally resolved. Michael Sousa also testified that he was not willing to buy the businesses if he had to assume a sizeable unknown liability, but on cross-examination admitted that he would consider purchasing the businesses subject to the discrimination claims if the purchase price were reduced by the amount of the discrimination plaintiffs' demand or if a sufficient portion of the sale proceeds was held in escrow to pay those claims in full as they are resolved.

On March 20, 2005, Jean Tien filed a timely appeal of the District Court's decision with this Court. As noted at the outset of this opinion, the appeal requires the Court to decide the following two issues: 1) whether a federal court has the authority to order the remedy of substantive consolidation under the Bankruptcy Code; and 2) whether a debtor has the ability to sell its assets free and clear of any successor liability claims under § 363(f) of the Bankruptcy Code. For the reasons that follow, the decision by the District Court for the District of Kelly is hereby reversed in its entirety, and the matter is remanded to the District Court for further proceedings consistent with this opinion.

II. Discussion

In civil appeals, a lower court's findings of fact are accorded special deference, and will not be disturbed on appeal unless "clearly erroneous." *Hirschfeld v. Spanakos*, 104 F.3d 16, 19 (2d Cir. 1997) (citation omitted). However, a district court's conclusions of law are reviewed *de novo*, and an appellate court need not pay any level of deference to a lower court's conclusions of law. *Keach v. United States Trust Co.*, 419 F.3d 626, 634 (7th Cir. 2005) (citation omitted). Since we disagree with the legal conclusions reached by the District Court with respect to both issues presently on appeal, there is no need for us to review the District Court's factual findings.

The Court will address each legal issue in turn.

A. Substantive Consolidation

As recognized by the United States Supreme Court more than seven decades ago, bankruptcy courts “are essentially courts of equity, and their proceedings inherently proceedings in equity.” *Local Loan Co. v. Hunt*, 292 U.S. 234, 240, 54 S. Ct. 695, 697, 78 L. Ed. 1230 (1934). As a court of equity, a bankruptcy court applies the principles and rules of equity jurisprudence in the exercise of the jurisdiction conferred upon it by the Bankruptcy Code and Title 28 of the United States Code. *See Pepper v. Litton*, 308 U.S. 295, 304, 60 S. Ct. 238, 244, 84 L. Ed. 281 (1939). The bankruptcy courts have exercised their equitable powers “in passing on a wide range of problems arising out of the administration of bankrupt estates.” *Id.* For example, these equitable powers have been invoked “to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done.” 308 U.S. at 304-05, 60 S. Ct. at 244, 84 L. Ed. 281. It is also well-accepted that bankruptcy courts, as courts of equity, have broad authority to modify the relationships between debtors and creditors. *United States v. Energy Res. Co.*, 495 U.S. 545, 549, 110 S. Ct. 2139, 2142, 109 L. Ed. 2d 580 (1990) (citations omitted).

Despite this seemingly broad grant of equitable authority, a bankruptcy court does not have “free-floating discretion to redistribute rights in accordance with [its] personal views of justice and fairness, however enlightened those views may be,” or use its equitable power to circumvent the Bankruptcy Code. *Disch v. Rasmussen*, 417 F.3d 769, 777 (7th Cir. 2005) (quoting *In re Chicago, Milwaukee, St. Paul & Pac. R.R. Co.*, 791 F.2d 524, 528 (7th Cir. 1986)). That is, a bankruptcy court must exercise its equitable powers within the confines of the

Bankruptcy Code. *Id.* See also *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206, 108 S. Ct. 963, 969, 99 L. Ed. 2d 169 (1988) (noting that “whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code”). As articulated recently by the Court of Appeals for the Second Circuit, a bankruptcy court’s inherent equitable power does not provide it with license “to create substantive rights that are otherwise unavailable under applicable law,” nor does it “constitute a roving commission to do equity.” *Smart World Technologies, LLC v. Juno Online Servs., Inc. (In re Smart World Technologies, LLC)*, 423 F.3d 166, 184 (2005) (quoting *New England Dairies, Inc. v. Dairy Mart Convenience Stores, Inc. (In re Dairy Mart Convenience Stores, Inc.)*, 351 F.3d 86, 91-92 (2d Cir. 2003)). Thus, the question is whether a bankruptcy court’s equitable power extends so far as to order the substantive consolidation of two or more bankruptcy estates. For the reasons that follow, this Court concludes that it does not.

The theory of substantive consolidation serves to combine the assets and liabilities of separate and distinct, but related, legal entities into a single pool and treat them as though they belong to a single entity. *Alexander v. Compton (In re Bonham)*, 229 F.3d 750, 764 (9th Cir. 2000) (citations omitted). In sum, substantive consolidation “enables a bankruptcy court to disregard separate corporate entities, to pierce their corporate veils in the usual metaphor, in order to reach assets for the satisfaction of debts of a related corporation.” *Id.* (quoting *James Talcott, Inc. v. Wharton (In re Cont’l Vending Mach. Corp.)*, 517 F.2d 997, 1000 (2d Cir. 1975)), *cert. denied*, 424 U.S. 913, 96 S.Ct. 1111, 47 L.Ed.2d 317 (1976). The consolidated assets “create a single fund from which all claims against the consolidated debtors are satisfied; duplicate and inter-company claims are extinguished; and, the creditors of the consolidated

entities are combined for purposes of voting on reorganization plans.” *Id.* (citation omitted). Those courts subscribing to the notion of substantive consolidation assert that the primary purpose behind the remedy “is to ensure the equitable treatment of all creditors.” *Id.* (citation omitted).

While the historical roots of substantive consolidation extend to at least as far back as the Bankruptcy Act of 1898, it cannot be disputed that neither the Bankruptcy Code nor the Federal Rules of Bankruptcy Procedure expressly authorize the substantive consolidation of separate bankruptcy estates. *See In re Standard Brands Paint Co.*, 154 B.R. 563, 567 (Bankr. C.D. Cal. 1993). Rather, substantive consolidation is the sole product of “judicial gloss.” *Fed. Deposit Ins. Corp. v. Colonial Realty Co.*, 966 F.2d 57, 59 (2d Cir. 1992) (citation omitted). In other words, substantive consolidation is nothing more than a construct of federal common law. Under the former Bankruptcy Act, the authority to order substantive consolidation was implied from the general equity powers of the bankruptcy court. *In re Stone & Webster, Inc.*, 286 B.R. 532, 538 (Bankr. D. Del. 2002) (citation omitted). Since the enactment of the Bankruptcy Code in 1978, however, those courts granting the remedy of substantive consolidation rely upon the alleged “general equity powers” of a bankruptcy court as expressed in § 105 of the Bankruptcy Code. *See In re Bonham*, 229 F.3d at 764 (citing *Union Sav. Bank v. Augie/Restivo Baking Co. (In re Augie/Restivo Baking Co.)*, 860 F.2d 515, 518 n.1 (2d Cir. 1988)).

The reliance upon § 105(a) of the Bankruptcy Code, together with a bankruptcy court’s general equitable powers, to order the substantive consolidation of separate bankruptcy estates is flawed in light of the United States Supreme Court decision in *Grupo Mexicano de Desarrollo*,

S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308, 119 S. Ct. 1961, 144 L. Ed. 2d 319 (1999).¹ In *Grupo Mexicano*, the Supreme Court held that a federal district court lacks jurisdiction to enjoin a defendant’s transfer of assets prior to judgment merely to protect the potential recovery of a general unsecured creditor. 527 U.S. at 333, 119 S. Ct. at 1975, 144 L. Ed. 2d 319. In analyzing whether a federal court has the power to exercise such equitable relief, the Supreme Court began by observing that the Judiciary Act of 1789 conferred on the federal courts jurisdiction over “all suits . . . in equity.” 527 U.S. at 318, 119 S. Ct. at 1968, 144 L. Ed. 2d 319. From this, the Supreme Court noted that the equity jurisdiction conferred upon the federal courts “‘is an authority to administer in equity suits the principles of the system of judicial remedies which had been devised and was being administered by the English Court of Chancery at the time of the separation of the two countries.’” *Id.* (quoting *Atlas Life Ins. Co. v. W.I. S., Inc.*, 306 U.S. 563, 568, 59 S. Ct. 657, 83 L. Ed. 987 (1939)). As the Supreme Court clearly concluded: “[s]ubstantially, then, the equity jurisdiction of the federal courts is the jurisdiction in equity exercised by the High Court of Chancery in England at the time of the adoption of the Constitution and the enactment of the original Judiciary Act, 1789.” *Id.* (citation omitted). From this pronouncement, this Court must ask whether the relief sought by ACME, namely, the substantive consolidation of separate bankrupt estates, was traditionally granted by courts of equity in 1789 when the Judiciary Act was promulgated.

A survey of the law of substantive consolidation reveals that the federal courts did not develop the underlying principles of the doctrine until the middle of the twentieth century, in

¹ We find unpersuasive the Third Circuit’s attempt to distinguish *Grupo Mexicano* on the grounds that bankruptcy is different. *See In re Owens Corning*, 419 F.3d 195, 209 n. 14 (3d Cir. 2005).

such cases as *Stone v. Eacho (In re Tip Top Tailors, Inc.)*, 127 F.2d 284 (4th Cir.), *cert. denied*, 317 U.S. 635, 63 S.Ct. 54, 87 L.Ed. 512 (1942), and *Fish v. East*, 114 F.2d 177 (10th Cir. 1940). The modern theory of substantive consolidation was not “invented” as part of the federal common law until the 1960's, when federal courts departed from their reliance upon state corporate law theories of “alter ego” or “instrumentality” status. *See, e.g., Chem. Bank N.Y. Trust Co. v. Kheel*, 369 F.2d 845, 847 (2d Cir. 1966) (“The power to consolidate should be used sparingly because of the possibility of unfair treatment of creditors of a corporate debtor who have dealt solely with that debtor without knowledge of its interrelationship with others”). In order to reconcile the equitable relief of substantive consolidation with *Grupo Mexicano*, the historical inquiry would be to find 18th Century precedent for an equitable remedy resulting in the assets and liabilities of one bankrupt company being combined with those of another debtor corporation for purposes of distribution to their combined debtors. *See* J. Maxwell Tucker, *Grupo Mexicano and the Death of Substantive Consolidation*, 8 Am. Bankr. Inst. L. Rev. 427, 442 (2000). Simply put, such precedent does not appear to exist. *Id.* at 443-44.

This Court does not question the proposition that equity is a flexible concept; however, in the federal system, that flexibility is confined within the broad boundaries of *traditional* equitable relief. *Grupo Mexicano*, 527 U.S. at 322, 119 S. Ct. at 1969, 144 L. Ed. 2d 319. As correctly recognized by the Supreme Court in *Grupo Mexicano*, “the equitable powers conferred by the Judiciary Act of 1789 did not include the power to create remedies previously unknown to equity jurisprudence. Even when sitting as a court in equity, we have no authority to craft a ‘nuclear weapon’” that would lead to the destruction of well-accepted principles and the undoing of the historical development of this country’s jurisprudence. 527 U.S. at 332, 119 S. Ct. at

1974, 144 L. Ed. 2d 319. In the absence of 18th Century English law precedent for an order of the substantive consolidation of distinct bankrupt estates, such an equitable remedy is simply not available. As previously noted, the theory of substantive consolidation arose during the middle of the twentieth century, and not with the Lord Chancellor prior to 1789. The *Grupo Mexicano* decision requires 18th Century precedent before a federal court may fashion the equitable remedy requested by ACME in this case.

In addition, the Court also rejects ACME's argument that § 105(a) of the Bankruptcy Code authorizes a federal court to order the substantive consolidation of bankruptcy estates. Under § 105(a), a court may exercise its equitable power only as a means to fulfill some specific Code provision. *In re Fesco Plastics Corp.*, 996 F.2d 152, 154 (7th Cir. 1993) (citations omitted). A bankruptcy court is simply not authorized to do whatever is necessary to reach an equitable result to further the goals of bankruptcy law in general,² but rather § 105(a) of the Code directs that a bankruptcy court may issue any order "necessary or appropriate" *to carry out the provisions of Title 11 of the United States Code*. See *In re Smart World Technologies, LLC*, 423 F.3d at 184 ("The equitable power conferred by section 105(a) is the power to exercise equity in carrying out the *provisions* of the Bankruptcy Code, rather than to further the purposes of the Code generally, or otherwise to do the right thing. This language suggests that an exercise of section 105 power be tied to another Bankruptcy Code section and not merely to a general bankruptcy concept or objective") (emphasis in original) (citations omitted). Section 105(a) does not "authorize the bankruptcy courts to create substantive rights that are otherwise unavailable

² While the Dissent focuses on the different treatment of creditors of these entities, we see nothing equitable about merging them. Where there are two separate corporations, with different sets of creditors, equity does not require that the assets available to one group be redistributed to the other.

under applicable law,” nor does it permit bankruptcy courts to act as “roving commission[s] to do equity.” *Southmark Corp. v. Grosz (In re Southmark Corp.)*, 49 F.3d 1111, 1116 (5th Cir. 1995). Because the remedy of substantive consolidation is a modern creature of federal common law, and does not exist within the confines of the Bankruptcy Code as an equitable remedy for courts to utilize, section 105(a) does not provide federal courts with an independent equitable power to order the substantive consolidation of separate bankruptcy estates.

Consequently, the District Court’s decision authorizing the substantive consolidation of the ACME, TAPCO, and CAPCO bankruptcy estates is hereby reversed, and the matter is remanded for further proceedings consistent with this opinion.

B. Sale of Assets Under § 363(f) of the Bankruptcy Code

The District Court also determined that the assets of these Debtors could be sold to SOUSA free and clear of any successor liability claims under § 363(f) of the Bankruptcy Code. For the reasons that follow, the District Court’s decision on this issue is also reversed, and the matter is remanded for further proceedings consistent with this opinion.

We note at the outset that no party contests the District Court’s conclusion that, as a matter of federal law, the claims of the discrimination plaintiffs could be asserted against SOUSA if it purchases CAPCO’s business. *See, e.g., Rego v. ARC Water Treatment Co.*, 181 F.3d 396, 401 (3d Cir. 1999) (citing *Musikiwamba v. ESSI, Inc.*, 760 F.2d 740, 750 (7th Cir. 1985)). The policy underlying the doctrine of successor liability within the context of employment discrimination claims “is to protect an employee when the ownership of his [or her] employer suddenly changes.” *Id.* (citing *Rojas v. TK Commc’ns, Inc.*, 87 F.3d 745, 750 (5th Cir. 1996)). The question presented here is whether § 363(f) of the Bankruptcy Code provides a

mechanism by which the assets of CAPCO can be sold free and clear of the discrimination plaintiffs' claims.

Section 363(f) of the Bankruptcy Code provides as follows:

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.

[11 U.S.C. § 363(f) (West 2005)].

The critical issue in this appeal is whether the pending employment discrimination claims against CAPCO constitute “interests” in property as contemplated by § 363(f) of the Bankruptcy Code. In analyzing § 363(f), it is clear that the term “interest” is not defined by the Bankruptcy Code. While the phrase “any interest” can be construed broadly, that phrase simply cannot be read in isolation. In other words, § 363(f) does not authorize sales of assets free and clear of *any interest*, but rather of *any interest in such property*. As the court in *Fairchild Aircraft Inc. v. Cambell (In re Fairchild Aircraft Corp.)*, 184 B.R. 910, 917-18 (Bankr. W.D. Tex. 1995), *vacated on other grounds*, 220 B.R. 909 (Bankr. W.D. Tex. 1998)³, stated, “[t]hese three additional words define the real breadth of *any interests*. The sorts of interests impacted by a

³ Although the Court vacated its original order because the parties settled the case, it made clear that the original opinion should retain its precedential value. See *In re Fairchild Aircraft Corp.*, 220 B.R. at 917 n. 10.

sale “free and clear” are *in rem* interests which have attached to the property. Section 363(f) is not intended to extinguish *in personam* liabilities.” (emphases in original). To construe “any interest” to encompass *in personam* claims would render the modifying words “in such property” mere surplusage. *Id.* at 918. *In personam* claims, such as the claims asserted by the discrimination plaintiffs in this case, do not represent an “interest in such property” of which the asset could be sold free and clear pursuant to § 363(f) of the Code. Furthermore, the Dissent fails to recognize that its treatment of successor liability claims as interests in property requires that the claims be given adequate protection under § 363(e).

Section 363(f) authorizes the sale of assets free and clear of specific interests in the property being sold. General, unsecured claimants, like the discrimination plaintiffs in this case, have no specific interest in a debtor’s property. Consequently, the Debtors cannot utilize § 363(f) of the Code to effectively “strip away” CAPCO’s contingent employment discrimination liabilities in contemplation of a sale of assets to SOUSA. Accordingly, the decision of the District Court permitting the sale of assets free and clear of any possible successor liability claims under § 363(f) of the Bankruptcy Code is hereby reversed, and the matter is remanded for further proceedings consistent with this opinion.

III. Conclusion

For the reasons set forth above, the determination of the District Court: (i) to substantively consolidate the bankruptcy estates of ACME, TAPCO, and CAPCO; and (ii) to permit the sale of assets free and clear of any possible successor liability claims under § 363(f) of

the Bankruptcy Code is hereby reversed, and the matter is remanded for further proceedings consistent with this opinion.

SCHMID, Circuit Judge, dissenting:

I must respectfully dissent from the majority's disposition of this case with respect to both issues on appeal.

A. Substantive Consolidation

The majority is correct that neither the Bankruptcy Code nor the Federal Rules of Bankruptcy Procedure expressly authorize the substantive consolidation of separate bankruptcy estates. However, the majority's reliance upon this point to deny substantive consolidation as a matter of law ignores eight decades of judicial precedent and the power imbued by Congress to the bankruptcy courts pursuant to § 105 of the Bankruptcy Code.

In the first few decades of the twentieth century, courts began recognizing the need to dispense with corporate formalities and the notion of limited liability under certain circumstances, and utilized various forms of relief such as "veil piercing," equitable subordination, and turnover orders to disregard corporate separateness between parent and subsidiary corporations. Indeed, in 1941 the United States Supreme Court gave its tacit approval to the equitable power to substantively consolidate two estates. *See generally Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 61 S. Ct. 904, 85 L. Ed. 1293 (1941). Early decisions in the corporate context applied essentially an alter ego or veil piercing test in assessing the propriety of substantive consolidation. *See, e.g., Fish v. East*, 114 F.2d 177 (10th Cir. 1940); *Stone v. Eacho (In re Tip Top Tailors, Inc.)*, 127 F.2d 284 (4th Cir.), *cert. denied*, 317 U.S. 635, 63 S.Ct. 54, 87 L.Ed. 512 (1942).

Thereafter, a series of decisions from the Second Circuit Court of Appeals in the 1960's and 1970's "articulated the contours of substantive consolidation which continue to guide current case law in this area." *Reider v. Fed. Deposit Ins. Corp. (In re Reider)*, 31 F.3d 1102, 1105-06 (11th Cir. 1994) (citations omitted). While it is unnecessary to recount the historical development of substantive consolidation, it is enough to note that such relief has been a part of the American judicial landscape since the early part of the twentieth century, and a federal court's equitable power to substantively consolidate separate bankruptcy estates survived the enactment of the Bankruptcy Code and is currently codified by § 105(a) of the Code.⁴ *See Alexander v. Compton (In re Bonham)*, 229 F.3d 750, 764 (9th Cir. 2000) ("At present, consistent with its historical roots, the power of substantive consolidation derives from the bankruptcy court's general equity powers as expressed in § 105 of the Bankruptcy Code"). Other than the majority's opinion in this instance, no case has held that a federal court cannot order the substantive consolidation of separate bankruptcy estates.

In my view, we are bound by the *Sampsell* opinion unless and until the Supreme Court revisits and reverses the position taken there. As the Third Circuit Court of Appeals aptly stated in *In re Owens Corning*, 419 F.3d 195, 209 n.14 (3d Cir. 2005), "[w]hat the Court has given as an equitable remedy remains until it alone removes it or Congress declares it removed as an option."

The distinction drawn by the Third Circuit between bankruptcy jurisdiction and general federal equitable jurisdiction is a complete response to the argument that the remedy of substantive consolidation is no longer available under the doctrine of *Grupo Mexicano de*

⁴ Further evidence of the doctrine's continued vitality is found in § 1123(a)(5)(C) of the Code.

Desarrollo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308, 119 S. Ct. 1961, 144 L. Ed. 2d 319 (1999). The *Grupo Mexicano* decision does not articulate a constitutional restriction on the equitable powers of the federal courts, but rather interprets the Judiciary Act of 1789 and the scope of the statutory grant of equitable jurisdiction conferred thereby. The case dealt with the general equitable jurisdiction of the federal courts and did not involve the jurisdiction granted in bankruptcy under 28 U.S.C. § 1334 or with the equitable powers conferred by § 105 of the Bankruptcy Code. As discussed above, § 105 incorporates the established substantive consolidation power. Since that section does not trace its roots to the Judiciary Act of 1789, *Grupo Mexicano* has no relevance to the question of whether the federal courts can order the substantive consolidation of separate bankruptcy estates. Cf. *Class Five Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 657-58 (6th Cir.) (rejecting *Grupo Mexicano* challenge to court's power to impose non-consensual non-debtor releases), *cert. denied sub nom., Class Five Nevada Claimants v. Dow Corning Corp.*, 537 U.S. 816, 123 S.Ct. 85, 154 L.Ed.2d 21 (2002).

In concluding that a federal court has the ability to substantively consolidate separate bankruptcy estates, the next inquiry is whether the District Court appropriately exercised the remedy under the circumstances of this case. Several factors lead me to conclude that the District Court was correct in ordering the substantive consolidation of the ACME, TAPCO, and CAPCO bankruptcy estates.

First, judicial efficiency and administrative ease justify substantive consolidation in this case. The three Debtor companies participated in numerous inter-company loans and transactions in their daily operations. Unraveling those transactions in order to determine

creditor payouts in the three separate reorganizations would be made extremely difficult due to the “sloppy” accounting practices of the Debtors. The costs of “retrojection” in this case could potentially render the estates of one or more of the Debtors administratively insolvent. In any event, every creditor of the three estates would benefit by consolidating the three Debtor estates in order to save the administrative costs of unraveling the inter-company transactions and loans.

Second, while the three Debtor companies recognized corporate formalities in governance, trade creditors did not recognize a separate identity among the three Debtors in their day-to-day transactions, but relied on the unity of the Debtors in extending credit. As ACME marketed and distributed TAPCO’s soda ash and CAPCO’s calcium chloride productions as its own, trade creditors often believed they were dealing with ACME, rather than one of its subsidiaries. Further, ACME routinely guaranteed the loans of its subsidiaries. To the rest of the world, ACME and its two subsidiaries operated as a single global producer of soda ash and calcium chloride.

Finally, a hypothetical calculation of the distributions to the general unsecured creditors in these three bankruptcy estates yields an unsettling and, in my view, inequitable disparity based on the lack of separate identity and the pervasive inter-company transactions. The District Court found that in the absence of substantive consolidation, the general unsecured creditors of ACME would get between 50 and 60 cents on the dollar, the general unsecured creditors of CAPCO would get between 65 and 75 cents on the dollar and the general unsecured creditors of TAPCO would get about seven cents on the dollar. To subject these trade creditors to such a small distribution when they believed they were dealing with ACME would be unconscionable. Consolidating the estates would yield a distribution of approximately 60 cents on the dollar for

the general unsecured creditor body according to the findings of the District Court. I cannot ignore such a disparate distribution in the face of pervasive inter-company transactions and mistaken identity.

Accordingly, I would affirm the District Court's finding of sufficient facts to warrant substantive consolidation in this case.

B. Sale of Assets Under § 363(f) of the Bankruptcy Code

In order to decide whether the District Court's authorization of the sale to SOUSA was proper, I must first consider the threshold question of whether the claims presented constitute an "interest in such property" within the meaning of 11 U.S.C. § 363(f). As with any question of statutory interpretation, I must begin with the words of the statute. *See United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989). Section 363(f) provides:

The trustee may sell property . . . 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.

[11 U.S.C. § 363(f) (West 2005)].

As the majority concedes, the meaning of the word "interest" is unclear. It is nowhere defined in the Code. Standing alone, it appears to be a broad concept, unrestricted in its scope. The phrase "in such property" merely requires a nexus between the property sold and the interest asserted. Such a nexus is easily supplied by the successor liability doctrine that ties CAPCO's

liability for the discrimination claims to CAPCO's assets and imposes that liability on SOUSA because of its acquisition of those assets. Such an interpretation seems the most logical in light of the language and purpose of this section. The majority, however, restricts the statute's reach to *in rem* property interests only, such as liens. This position is contrary to the policies behind § 363(f).

I would follow the reasoning of the Fourth Circuit Court of Appeals in *United Mine Workers of America 1992 Benefit Plan v. Leckie Smokeless Coal Co. (In re Leckie Smokeless Coal Co.)*, 99 F.3d 573 (4th Cir. 1996), *cert. denied*, 520 U.S. 1118, 117 S.Ct. 1251, 137 L.Ed.2d 332 (1997). There, the bankruptcy court issued an order under § 363(f), extinguishing a purchaser's successor liability arising under the Coal Act. *Id.* at 579. In discussing whether the successor liability claims were encompassed by the statute, the Court rejected the proposition that § 363(f) was restricted to *in rem* interests. *Id.* at 581. Rather, an "interest in such property" can arise for § 363(f) purposes from a special relationship between the assets and the claims. *Id.* at 582.

In this case, the CAPCO discrimination plaintiffs do not possess *in rem* interests. Instead, their claims arise from their employment with CAPCO. Thus, it logically follows that any sale of CAPCO, or all of CAPCO's assets, is intrinsically connected with the discrimination plaintiffs' successor liability claims because it is from the sale of those assets that their successor liability claims arise. This connection is sufficient to find that the discrimination plaintiffs have interests in property within the meaning of § 363(f), thereby subjecting their claims to potential extinction. *See United States v. Knox-Schillinger (In re Trans World Airlines, Inc.)*, 322 F.3d 283, 290 (3d Cir. 2003).

This may seem like a harsh result. Extinguishing claims that arise from a congressional enactment is not something that should be taken lightly. Yet, on the facts before the Court, this sale is necessary in order to realize the full value of these assets. It should be noted that absent a sale free and clear of the successor liability claims, SOUSA will reduce its offer to reflect its potential exposure to the successor liability claims, or perhaps might not purchase at all. At present, the discrimination plaintiffs are unsecured creditors of CAPCO and are entitled only to share the available assets equally with the other unsecured creditors on a pro rata basis. If the sale is subject to their claims, then the discrimination plaintiffs will be able to receive full payment of their entire claims from the successor entity. This result not only allows them to recover more than similarly situated unsecured creditors of CAPCO, but, much worse, their extra recovery comes at the expense of the other unsecured creditors, who will have to share a correspondingly smaller pool of sale proceeds. Such a result is contrary to the policy of § 363(f), which is to maximize the value realized in the sale of assets. It also violates the fundamental bankruptcy principle of equality of distribution.

Accordingly, a sale free and clear of the discrimination plaintiffs' claims is permitted by § 363(f). Thus, the District Court's decision authorizing a free and clear sale to SOUSA pursuant to § 363(f) of the Bankruptcy Code was proper and should be affirmed. For the aforementioned reasons, I cannot join the majority's opinion.