

No. 05-628

In the

SUPREME COURT OF THE UNITED STATES

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

Acme Chemical Industrial Products, Inc.,

Petitioner,

v.

Jean Tien,

Respondent.

Brief of Respondents

QUESTIONS PRESENTED

- I. 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.

- II. 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.

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STATEMENT OF FACTS

Jean Tien, the Appellee in the instant appeal, along with a number of other female employees, filed a class action suit two years ago in the District Court of Kelly against their employer, Chemical American Product Company, Inc. (“CAPCO”), for alleged sex and gender discrimination in violation of Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000(e), *et seq.*, and the Equal Pay Act of 1963, 29 U.S.C. § 206(d), *et seq.* (tr. 6). CAPCO and Trona Ash Products Company, Inc. (“TAPCO”) are the two wholly-owned subsidiaries of the Appellant, Acme Chemical Industrial Products, Inc. (“ACME”), which sells the soda ash and calcium chloride that its two subsidiaries produce (tr. 2-3). The three companies are very closely related: they all use a centralized cash management system; TAPCO and CAPCO have the same corporate officers and board of directors; and a number of members of the board of directors of TAPCO and CAPCO serve on the board of directors for ACME (tr. 5).

Over the last few years, the price of soda ash has fallen dramatically in the U.S. and energy prices have increased significantly causing ACME to default on its various loans from a number of lenders (tr. 6). After failing to reach an agreement with its lenders to restructure its debt, ACME and its subsidiaries filed petitions under Chapter 11 of the Bankruptcy Code in the District of Kelly where they are incorporated (tr. 7). The class action discrimination lawsuit was pending when the bankruptcy petitions were filed. The companies were administratively consolidated, and they eventually decided to sell the businesses. Sousa Industries, Inc. (“SOUSA”) offered the highest price for ACME and its subsidiaries and required that the companies be sold as one entity. SOUSA also conditioned its purchase of the companies on being immunized from any successor liability from the lawsuit against CAPCO (tr. 6).

ACME filed a motion with the Bankruptcy Court asking the Court to substantively consolidate the three bankruptcy estates and to approve the sale to SOUSA free and clear of all liens, claims, and encumbrances under § 363 (f) of the Bankruptcy Code. Jean Tien and a number of the other plaintiffs in the discrimination suit against CAPCO filed objections to ACME's motion and also filed a motion with the District Court to withdraw the reference of the bankruptcy cases of all three companies from the Bankruptcy Court (tr. 8). The District Court granted the motion of the discrimination plaintiffs to withdraw reference and heard oral argument and testimony regarding ACME's motion. The District Court granted ACME's motion. The Court approved the substantive consolidation primarily on the grounds that it would be extremely difficult to divide up the money received from the sale between the three companies and that the creditors of the three companies did not regard them as separate entities when lending money (tr. 9).

Jean Tien filed an appeal of the District Court's decision with the Thirteenth Circuit Court of Appeals, which reversed (tr. 10, 19). The Court of Appeals held that the federal courts do not have the power to substantively consolidate bankrupt estates under their equity powers. The Court also held that §363(f) of the Bankruptcy Code could not be used to allow SOUSA to purchase CAPCO's assets without incurring its potential liability for the discrimination claims. Subsequently, ACME filed an appeal of the Circuit Court's decision to this Court.

SUMMARY OF THE ARGUMENT

Federal courts do not have the authority to order the substantive consolidation of bankruptcy estates under their grant of equity jurisdiction. The federal courts may only employ the specific equitable remedies that were available in 1789 in the English Court of Chancery. They may not grant equitable relief based on the principles or general aims of traditional equity jurisprudence. Substantive consolidation is a form of equitable relief that was not available in the English Court of Chancery. The English Chancellor did not grant a type of equitable relief bearing any resemblance to substantive consolidation. The doctrine of substantive consolidation was not developed until the early part of the twentieth century. Therefore, the federal courts transgress the boundaries of their equity power every time they order the substantive consolidation of two or more bankrupt estates. The federal courts should no longer be able to apply the equitable remedy of substantive consolidation that they developed, but they would still have the power to consolidate debtors under Chapter 11 of the Bankruptcy Code or by applying the corporate law doctrines of a particular state.

Furthermore, the 13th Circuit was correct in holding that the text of § 363(f) of the Bankruptcy code only permits the sale of property from the estate free of any interests arising from *in rem* claims against the property subject to sale, and did not allow a sale free of interests arising from *in personam* claims against an entity based on the doctrine of successor liability. This finding is supported by the text of § 363(f) and an analysis of the policy implications of an expansive reading of § 363(f). Such a reading would conceivably allow courts to sell property out of the estate free of any interest, including the interests of the creditors arising out their primary claims against the debtor in bankruptcy.

Finally, even if the 13th Circuit was incorrect in finding that § 363(f) does not authorize the sale of property free of interests other than those arising from claims *in rem* against the property, the interests of respondents are still entitled to adequate protection under § 363(e) of the bankruptcy code. § 363(e) mandates adequate protection of any interest in property subject to discharge under § 363.

ARUGMENT

I. Bankruptcy courts' general equity jurisdiction does not grant to them the authority to order the substantive consolidation of separate, but related legal entities because it is not a traditional equitable remedy.

All federal courts acknowledge that substantive consolidation is an equitable remedy, not one codified by statute.¹ Although there is a “traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relations,” there are limitations to those equitable powers. *U.S. v. Energy Resources Co., Inc.*, 495 U.S. 545, 549 (1990). This Court has stated that “[w]e do not question the proposition that equity is flexible; but in the federal system, at least, that flexibility is confined within the broad boundaries of traditional equitable relief.” *Grupo Mexicano de Desarrollo S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308, 322 (1999). Substantive consolidation, although an equitable remedy having been employed for many years, is not the type of “relief traditionally accorded by courts of equity.” *Grupo Mexicano*, 527 U.S. at 319.

In the *Grupo Mexicano* decision, this court reaffirmed its long-standing holding that the equity jurisdiction granted to the federal courts by the Judiciary Act of 1789 ““is an authority to administer in equity suits the principles of the system of judicial remedies which had been devised and were being administered by the English Court of Chancery at the time of the separation of the two countries.”” *Id.* at 318 (quoting *Atlas Life Ins. Co. v. W.I. Southern, Inc.*, 306 U.S. 563, 568 (1939)). Moreover, the Court made it clear that federal courts have at their

¹ See, e.g., *In re Auto-Train Corp., Inc.*, 810 F.2d 270, 276 (D.C. Cir. 1987) (“Although the Bankruptcy Code nowhere specifically authorizes consolidation of separate estates, courts may order consolidation by virtue of their general equitable powers.”), *In re Augie/Restivo Baking Co., Ltd.*, 860 F.2d 515, 518 (2d. Cir. 1988) (“Substantive consolidation has no express statutory basis but is the product of judicial gloss.”)

disposal only the specific equitable remedies developed in England before 1789, rather than the principles behind those remedies: “[t]his expansive view of equity must be rejected.” *Id.* at 321. This notion was reinforced in the dissenting opinion: “[f]rom the beginning, we have defined the scope of federal equity in relation to the principles of equity existing at the separation of this country from England...; we have never limited federal equity jurisdiction to the specific practices and remedies of the Pre-Revolutionary Chancellor.” *Id.* at 336. (Ginsburg, J., dissenting) (emphasis in original).

Substantive consolidation is an equitable doctrine foreign to equity jurisprudence as it existed in 1789, that applies the “principles of equity” rather than being an adaptation of a specific remedy used by the English Court of Chancery *Id.* First of all, there exist no English bankruptcy cases decided before 1789 involving an equitable remedy similar to substantive consolidation.² Secondly, the doctrine of substantive consolidation in the corporate context could not have existed in the 18th century because corporations were not allowed to hold stock in other corporations until 1832.³ Of course, if there was a traditional equitable remedy that involved the consolidation of two estates for the purpose of compensating creditors, then *Grupo Mexicano* may not prevent substantive consolidation from continuing as a viable equitable remedy in our federal courts.

The English Court of Chancery never employed a remedy similar to substantive consolidation. It could be argued that in the area of partnerships there was consolidation of separate estates. The creditor of a partnership could get paid out of both the joint estate of the

² See Marcie S. Krieger, “*The Bankruptcy Court is a Court of Equity?*” *What Does That Mean?* 50 S. Car. L. Rev. 275, 277 (1999) (“The English Chancery court proceeding is commonly accepted as the ancestor of American bankruptcy law and procedure. This assumption is incorrect. Statutes created bankruptcy remedies and insolvency rights in England. Bankruptcy proceedings were different than equity proceedings.”).

³ Edward V. Robinson, *The Holding Corporation-I*, 18 Yale Rev. 390, 400-07 (1910).

partners, and, if not fully compensated, then out of the individual partner's separate estates. However this consolidation was a remedy at law not in equity.⁴ Equity was involved in determining the priority between the partnership creditors and the individual creditors in the partnership assets and the individual assets.⁵ Accordingly, there was no equitable remedy available in 1789 in England that bears resemblance to the modern doctrine of substantive consolidation.

One could argue that substantive consolidation was authorized as a legitimate equitable remedy by this Court in its only decision relating to the doctrine. *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215 (1941). *Sampsell* involved a man who "formed a corporation for the purpose of hindering, delaying and defrauding his creditors." *Id.*, 313 U.S. at 217. The man became insolvent and filed bankruptcy. *Id.* at 216. The bankruptcy referee "ordered that the property of the corporation was property of the bankrupt estate and that it be administered for the benefit of the creditors of the estate." *Id.* at 217. The question in the case did not relate to the consolidation of the estates, but dealt with whether a creditor of the fraudulent corporation had priority in the corporate assets over the creditors of the individual bankrupt. *Id.* at 219. In *Sampsell*, the Court did use the phrase "the order consolidating the estates," but the Court did not give its assent to the doctrine of substantive consolidation, as we know it today. *Id.* The Court merely recognized that the bankruptcy referee had applied the state corporate law concept of "piercing the corporate veil" properly in this case: "Mere legal paraphernalia will not suffice to transform into a substantial adverse claimant a corporation whose affairs are so closely

⁴ Joseph Story, 2 *Commentaries on Equity Jurisprudence as Administered in England and America*. § 918 (14th ed. 1918). ("[A]t law a joint creditor may proceed directly against the separate estate.").

⁵ *Id.* ("[T]he separate creditors of each partner are entitled to be first paid out of the separate effects of their debtor before the partnership creditors can claim anything which also can be accomplished by the aid of a court of equity.").

assimilated to the affairs of the dominant stockholder that in substance it is little more than his corporate pocket.” *Id.* at 218. The *Sampsell* decision did not make substantive consolidation a traditional equitable doctrine. It was a doctrine created in the early part of the twentieth century, not one that can be traced back to the 18th century.

Although it was not known by the name of substantive consolidation, the doctrine grew out of state corporate law theory: “[e]arly decisions in the corporate context applied essentially an alter ego or pierce the corporate veil test in assessing the propriety of substantive consolidation.” *In re Reider*, 31 F.3d 1102, 1105 (11th Cir. 1994). The Tenth Circuit Court of Appeals was the first to approve the substantive consolidation of a bankrupt corporation and its subsidiary. *Fish v. East*, 114 F.2d 177, 177 (10th Cir. 1941). In *Fish v. East* the Court did not apply the corporate law principles of a particular state, but produced its own set of factors for the “determination as to whether a subsidiary is an ‘instrumentality’.” *Fish*, 114 F.2d at 191. *Fish v. East* and other early substantive consolidation cases did not explicitly follow state law standards when a trustee’s request to pierce the corporate veil and combine the assets and liabilities of a parent corporation with its subsidiary was granted.⁶ However, to the extent that a bankruptcy court applies a particular state’s corporate law in ordering substantive consolidation, they will not exceed the bounds of federal equity jurisdiction because they will be applying substantive law not an equitable remedy. State corporate law was not followed in this case, and it has not been normally followed in other cases involving the doctrine of substantive consolidation as it has evolved.

Many courts have acknowledged that the modern doctrine of substantive consolidation is no longer guided by state corporate law principles. First of all, substantive consolidation is

⁶ The courts that authored these decisions may have been guilty of creating federal common law in violation of the *Erie* doctrine. *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938).

ordered “typically to avoid the expense or difficulty of sorting out the debtor’s records to determine the separate assets and liabilities of each affiliated entity.” *In re Auto-Train Corp., Inc.*, 810 F.2d at 276. Secondly, substantive consolidation is motivated by fairness to creditors. For example, one court has stated that “[t]he focus of piercing the corporate veil is the limited liability afforded to a corporation...[while] [s]ubstantive consolidation...has a narrower focus: ‘the equitable treatment of all creditors’.” *F.D.I.C. v. Colonial Realty Co.*, 966 F.2d 57, 61 (2d Cir. 1992). Of course, courts recognize that it is virtually impossible to ensure that all creditors are treated equitably. They suggest that substantive consolidation should be used “sparingly because of the possibility of unfair treatment of creditors.” *Chemical Bank New York Trust Co. v. Kheel*, 368 F.2d 845, 847 (2d Cir. 1966). The potential for unfair treatment arises out of the fact that “[b]ecause the entities to be consolidated are likely to have different debt-to-asset ratios, consolidation ‘almost invariably redistributes wealth among the creditors of the various entities’.” *Eastgroup Properties v. Southern Motel Ass’n, Ltd.*, 935 F.2d 245, 248 (11th Cir. 1991) (quoting *In re Auto-Train Corp., Inc.*, 810 F.2d at 276.). To avoid this potential for harm, “before ordering consolidation, a court must conduct a searching inquiry to ensure that consolidation yields benefits offsetting the harm it inflicts on objecting parties.” *In re Auto-Train Corp., Inc.*, 810 F.2d at 276.

It is quite clear that substantive consolidation is primarily a doctrine of exigency, not a doctrine of equity. Much like the dissenting opinion in *Grupo Mexicano*, bankruptcy courts justify the doctrine of substantive consolidation by pointing to the “‘the grand aims of equity’” and “assert[ing] a general power to grant relief whenever legal remedies are not ‘practical and efficient’.” *Grupo Mexicano*, 527 U.S. at 321. The federal courts do not refer to a specific remedy found in traditional equity jurisprudence as grounds for employing substantive

consolidation; rather, they speak of the “equitable treatment of all creditors.” Similarly, bankruptcy courts justify the use of substantive consolidation by claiming that the tools Congress has given to them through the Bankruptcy Code are inadequate to deal with the “increasing complexity of modern business relations.” *Id.* at 337. For instance, one court has stated that substantive consolidation “has its genesis in the increased judicial recognition of the widespread use of interrelated corporate structures by subsidiary corporations operating under a parent entity’s corporate umbrella for tax and business purposes.” *Eastgroup*, 935 F.2d at 249. Of course there will be cases “where the interrelationships of the group [of debtors] are hopelessly obscured and the time and expense necessary even to attempt to unscramble them so substantial as to threaten the realization of any net assets for all the creditor.” *Kheel*, 368 F.2d at 847. However, the bankruptcy courts can use state corporate law doctrines of “alter ego” or “piercing the veil” to tap the assets of affiliated debtors.

Although substantive consolidation is not a “type of relief that has never been available before,” it still is not the type of relief that was historically available in courts of equity. *Grupo Mexicano*, at 322. Although this Court has never held that substantive consolidation is an equitable remedy beyond the wide limitations of federal equity jurisdiction, this court has never declared that it is within those limitations. Although substantive consolidation is no “nuclear weapon” like the preliminary injunction at issue in *Grupo Mexicano*, it is a powerful remedy that affects the substantive rights of all debtors and creditors. *Id.* at 332.

Most importantly, though, this powerful remedy was never explicitly or implicitly granted to the bankruptcy courts by Congress. If Congress had intended to give to bankruptcy judges the power to consolidate separate debtor estates, then it would have done so explicitly. To allow the bankruptcy courts to wield this weapon is “incompatible with the democratic and

self-deprecating judgment” that the equitable powers given to the federal courts do not “include the power to create remedies previously unknown to equity jurisprudence.” *Id.* This Court stated in *Grupo Mexicano* that the “debate over this formidable power over debtors should be conducted and resolved where such issues belong in our democracy: the Congress.” *Id.* This Court should allow the issue of whether bankruptcy judges should have the power to order the substantive consolidation of related legal entities to be debated and resolved in Congress as well.

II. Section 105(a) of the Bankruptcy Code does authorize bankruptcy judges to order the substantive consolidation of separate debtor estates.

Section 105(a), which was included in the Bankruptcy Reform Act of 1978, states that: [t]he court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title...” 11 U.S.C. § 105(a) (1994). Since the enactment of the Bankruptcy Code, nearly all courts have cited section 105(a) as the source of a bankruptcy court’s equitable powers. Whether a bankruptcy court’s general equitable powers come from section 105(a) or from its status as a “unit” of a district court, the equity jurisdiction conferred on bankruptcy courts can be no greater than the equity jurisdiction of a district court because the *Grupo Mexicano* limitation on equitable remedies applies to all federal courts. 28 U.S.C. § 151 (1994).

It could be argued that section 105(a) was intended by Congress as an independent grant of equitable authority, not subject to the limitations placed on the district courts, to the bankruptcy courts the to fashion any type of equitable remedy to carry out the general policies of the Code. Substantive consolidation would certainly be a permissible equitable remedy under such general equitable powers. However, this Court made it very clear that “whatever equitable

powers remain in the federal courts must and can only be exercised within the confines of the Bankruptcy Code.” *Northwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988). The Court also recently declared: “Bankruptcy courts are not authorized in the name of equity to make wholesale substitution of the underlying law controlling the validity of a creditor’s entitlements, but are limited to what the Bankruptcy Code itself provides.” *Raleigh v. Illinois Dep’t of Revenue*, 530 U.S. 15, 24-25 (2000).

Although these decisions did not define the scope of section 105(a), the Court has indicated that there is nothing in the Bankruptcy Code that gives a bankruptcy court the authority to use its equitable powers to accomplish anything independent of a specific Code provision.⁷ As stated by the Seventh Circuit Court of Appeals: “when a specific Code section addresses an issue, a court may not employ its equitable powers to achieve a result not contemplated by the Code.” *In re Fesco Plastics Corp.*, 996 F.2d 152, 154 (7th Cir. 1993). Of course, this Court has held that there is a “traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relations.” *Energy Resources Co.*, 495 U.S. at 549. Nevertheless, this authority does not include the ability to “modify creditor-debtor relations” in a manner in which the Bankruptcy Code does not prescribe. The fact remains that there is no provision in the Code that expressly calls for a bankruptcy court to order the consolidation of separate legal entities in situations where related corporations have been regarded by creditors as a single entity. If Congress had intended for the bankruptcy courts to have this remedy, then it would have explicitly granted it to the courts in the Bankruptcy Code and also provided the

⁷ See 1 COLLIER ON BANKRUPTCY ¶ 105.01 [1] (Lawrence P. King et. al. eds., 15th ed. rev 1997). (“Section 105 uses the term ‘provisions’ and not the term ‘purposes’ in describing the bankruptcy court’s power to effect the mandate of the Bankruptcy Code. The statutory language thus suggests that an exercise of section 105 power be tied to another Bankruptcy Code section and not merely to a general concept or objective.”).

courts with uniform standards to ensure that creditors were treated fairly and the limited liability of debtors was not disregarded. Nothing in section 105(a) indicates that Congress intended to give such authority to the bankruptcy courts. However, Congress did put one provision in the Bankruptcy Code that does allow for the consolidation of separate debtor estates.

III. Section 1123(a)(5)(c) of the Bankruptcy Code is the source of substantive consolidation, not the general equitable authority of the federal courts.

Section 1123(a)(5)(c) states that a Chapter 11 plan shall provide for adequate means for the plan's implementation, such as "merger or consolidation of the debtor with one or more persons." 11 U.S.C. § 1123(a)(5)(c). This provision of the Code should be regarded as the granting of authority to bankruptcy judges to issue orders of substantive consolidation, but judges still point to their equity powers as the basis for the doctrine. They continue to do this primarily because substantive consolidation in its equitable form is subject to much fewer restrictions. The substantive consolidation authorized by section 1123(a)(5)(c) does not allow a judge to independently issue an order of consolidation. A judge can only issue an order of consolidation as part of a confirmable Chapter 11 reorganization plan. In order for a court to confirm a plan the multiple requirements set forth in section 1129 of the Code must be met. 11 U.S.C. § 1129. Among the most important requirements is the "best interest test," which requires that the impaired creditors either vote for the plan or "receive not less than the amount that the holder would so receive or retain if the debtor were liquidated under Chapter 7 of this title." 11 U.S.C. § 1129 (a)(7)(A)(i-ii). Section 1129 (b) also is very important in that it allows a court only to confirm a "plan [that] does not discriminate, and is fair and equitable, with respect

to each class of claims or interests that is impaired under, and has not accepted, the plan. 11 U.S.C. § 1129 (b).

Congress has given the bankruptcy courts clear standards governing the implementation of Chapter 11 reorganization plans. These same standards apply to an order of substantive consolidation that is included in a reorganization plan. If the Congress had wanted to give free reign to the bankruptcy courts to continue to apply and develop the judge-made doctrine of substantive consolidation, then Congress would have treated it similarly to the doctrine of “equitable subordination”. 11 U.S.C. § 510 (c) (1). Section 510 (c) (1) states that courts may use the “principles of equitable subordination” in subordinating claims. *Id.* The legislative history indicates that Congress “intended that the term ‘principles of equitable subordination’ follow existing case law and leave to the courts the development of this principle.” 124 Cong. Rec. 32398 (1978) (Rep. Edwards).

In 1978 Congress did not leave it to the courts to continue to use the equitable doctrine of substantive consolidation. The intent behind section 1123(a)(5)(c) is unclear, but this provision does not authorize the use of substantive consolidation in its current equitable form. The consolidation of two or more estates can only be ordered in the Chapter 11 context, and a bankruptcy judge may not order it unless it is part of a confirmable plan. Federal courts must follow the standards prescribed by Congress for substantive consolidation, not the standards that they set down for themselves.

IV. § 363(f) does not authorize sales of property free and clear of interests arising from claims *in personam* against the debtor and successor entities

The 13th Circuit was correct in ruling that § 363(f) of the bankruptcy code only permits the sale of property in a bankruptcy proceeding “free from any interest” when those interests are interests that arise from *in rem* claims against the property. Its finding is supported by the text of the § 363(f), the legislative comments to § 363, and an analysis of the policy implications of an expanding reading of § 363(f). Accordingly, § 363(f) does not authorize the sale of property free of claims based on the doctrine of successor liability, as those claims are claims *in personam* against the successor entity.

The text of § 363(f) states that property being sold under the section is sold free of any interest “in such property.” The 13th Circuit, quoting from *Fairchild Aircraft Inc. v. Cambell*, correctly concluded that although the term “interest” as used in § 363(f) is broad in scope and subject to interpretation, the phrase “in such property” limits the scope of § 363(f) to *in rem* interests. Record at 17-18 (quoting *Fairchild Aircraft Inc. v. Cambell (In re Fairchild Aircraft Corp.)*, 184 B.R. 910, 917-18 (Bankr. W.D. Tex. 1998)). The court noted that “[t]he sorts of interests impacted by a sale ‘free and clear’ are *in rem* interests which have attached to the property” and made clear that “[s]ection 363(f) is not intended to extinguish *in personam* liabilities.” *Id.* at 18. As the 13th Circuit noted, any reading of § 363(f) that expands its scope beyond interests arising from *in rem* claims “would render the modifying words ‘in such property’ mere surplusage.” *Id.* In order to give the proper effect to the language of § 363(f) as passed by Congress, the section must be interpreted as only authorizing sales of property free of interests arising from *in rem* claims against the property subject to sale.

This interpretation of § 363(f) is supported by an analysis of the consequences of an expansive reading of the section. Bankruptcy courts generally have the power to extinguish *in personam* claims against the debtor. *Johnson v. Home State Bank*, 501 U.S. 78, 84 (1991) (explaining the scope of the bankruptcy court’s powers with respect to extinguishing liability). However, in so doing, the bankruptcy court must seek to equitably distribute assets of the debtor among creditors of the estate. *Begier v. I.R.S.*, 496 U.S. 53, 54 (1990) (“Equality of distribution among creditors is a central policy of the Bankruptcy Code.”). In other words, a primary function of the bankruptcy process is to “convert the estate of the bankrupt into cash and distribute it among creditors.” *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913). Bankruptcy courts do not, however, generally have the power to extinguish *in rem* interests in the debtor’s property, unless specifically authorized to do so by several narrow exceptions to the bankruptcy code. *Johnson*, at 79. One of these exceptions is § 363(f).⁸ However, if the Court were to interpret § 363(f) to allow sales of property free of interests other than those arising from *in rem* claims, including interests arising from *in personam* claims against an entity based on the doctrine of successor liability, it would allow courts to effectively strip every creditor of protection under the bankruptcy code at will. Courts could conceivably authorize the sale of any asset of the debtor free from any interest at all, as the primary claims of creditors against a debtor in bankruptcy could easily be characterized as “interests in such property” under an expansive reading of § 363(f). Such a result would clearly be at odds with one of the primary purposes of the bankruptcy code, the equitable distribution of assets among creditors.

⁸ See generally Rosemary Williams, *Special Commentary: Bifurcation and avoidance, or “stripping” of liens, security interests, and encumbrances held by undersecured creditors by rehabilitating and liquidating debtors in bankruptcy*. 158 A.L.R. Fed. 1 (2005) (discussing exceptions to the general rule that bankruptcy courts cannot extinguish *in rem* claims against debtor’s property).

Although some courts have interpreted § 363(f) as authorizing sales of property from the estate free of interests arising from claims other than those *in rem*, others have found that the section is limited in scope to a sale free of interests arising from *in rem* claims. Courts that have given an expansive reading to § 363(f), they have generally failed to consider both the textual interpretation issue and the policy consequences outlined above. The dissent in the 13th Circuit opinion provides a fair example of their reasoning.

The “nexus” or “special relationship” test advocated by the dissent in the 13th Circuit opinion is flawed precisely because it would expand the definition of “interest” under § 363(f) to include more than interests arising from *in rem* claims against the property subject to sale. Record at 25. The dissent, in interpreting “interest in such property” to include all instances where a special relationship exists “between the assets and the claims [of the creditors against the debtor]” or where there exists a “nexus between the property sold and the interest asserted” would conceivably expand § 363(f) to cover any sale of property from the estate. Record at 23-24. Because the “special relationship” or “nexus” needed for a sale under § 363(f) is not further defined, a court could easily characterize the claim of any creditor against the debtor in bankruptcy as giving rise to an “interest in such property” for the purposes of § 363(f). As outlined above, this type of broad definition of what meets the criteria for sale under § 363(f) is clearly against one of the primary purposes of the bankruptcy code, and so the Court should reject the “special relationship” test advocated by the dissent.

For the reasons set forth above, we urge this Court to find that 11 U.S.C. § 363(f) only authorizes the sale of property from the estate of a debtor free of interests arising from claims *in rem* against the property to be sold. Furthermore, we urge this Court to specifically hold that §

363(f) does not authorize the sale of property free of interests arising from *in personam* claims against successor entities pursued under the doctrine of successor liability.

V. § 363(e) requires adequate protection of interests of respondents even if sale is authorized under § 363(f)

In the alternative, however, even if this court concludes that § 363(f) allows the sale of property free of interests arising from *in personam* claims, such a sale still requires the protection of the respondents under 11 U.S.C. § 363(e). Section § 363(e) provides that “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.” 11 U.S.C. § 363(e) (West 2005). Although the text does not define exactly what constitutes adequate protection under the section, the comments suggest an answer. Specifically, the notes to § 363 provide that “[u]nder subsection[]...(e), the use, sale, or lease of property is further limited by the concept of adequate protection” and that “[m]ost often, adequate protection in connection with a sale free and clear of other interests will be to have those interests attach to the proceeds of the sale.” 11 U.S.C. § 363 note (West 2005).

Although there is some authority to suggest that unsecured creditors of the debtor are not entitled to adequate protection under § 363(e),⁹ such a conclusion would be clearly erroneous if

⁹ *In re Dairy Market Convenience Stores, Inc.*, 351 F.3d 86, 90 (2d Cir. 2003) (The adequate protection provision of 11 U.S.C. § 361 protects only secured creditors); *See Pileckas v. Marcucio*, 156 B.R. 721, 725 (N.D.N.Y. 1993) (“There is no express statutory requirement that holders of unsecured claims be provided [the] 'adequate protection' of § 361.”), *In re Pioneer Commercial Funding Corp.*, 114 B.R. 45, 48 (Bankr. S.D.N.Y. 1990) (“[T]he concepts of

this Court concludes that § 363(f) allows the sale of property free of interests arising from *in personam* claims against the debtor or its successor entity. § 363(e) provides that “on request of *an entity that has an interest in property...proposed to be used, sold, or leased* by the trustee, the court...shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest.” (emphasis added). § 363(f) provides that the “trustee may *sell property under...this section free and clear of any interest in such property of an entity.*” (emphasis added). A finding by the Court that § 363(f) authorizes the sale of property free of interests arising from *any* claims an entity might have against the debtor, while simultaneously holding that § 363(e) denies adequate protection to those entities, would be to define an entity with an interest in property differently in two sections of the bankruptcy code that sit side by side in the code. Such a result would be at the very least confusing to courts and potential litigants in resolving disputes and is at most an absurd result that Congress could never have intended in enacting § 363 as a whole.

The result of providing protection under § 363(e) to sales under § 363(f) involving *in personam* claims are effectively the same those that would be reached if the assets were not stripped of interests under § 363(f). The respondents would join the group of general unsecured creditors of the estate of CAPCO and take their pro rata share of the pool allocated to those creditors if and when their suit is reduced to a judgment against CAPCO. However, given the policy implications outlined above, we suggest that the better answer to this question is a finding by the Court that § 363(f) only allows the sale of assets free from interests arising from *in rem* claims against the property. This result gives effect to the entirety of the language of the section

adequate protection of an interest in property and the existence of an equity interest in property do not apply to unsecured claims.”)

and avoids a potentially catastrophic expansion of the scope of 363(f) to allow the extinguishment of any and all creditors' interests in the bankruptcy proceeding.

Accordingly, we urge the Court to hold that § 363(f) only authorizes the sale of property free and clear of any interests arising from claims *in rem* against the property subject to sale, and does not authorize the sale of property free of interests arising from claims *in personam* against the debtor or any entities that may be liable for claims against the debtor under the doctrine of successor liability. In the alternative, however, we urge the Court to hold that even if property is subject to sale under § 363(f) free of interests arising from *in personam* claims against the debtor or successor entities, general unsecured creditors like the respondents are still entitled to adequate protection under § 363(e) of the bankruptcy code.

CONCLUSION

The 13th Circuit was correct in holding that federal courts do not have the power to substantively consolidate the estates of debtors in bankruptcy. Substantive consolidation is not a traditional equitable remedy, but was created and developed by federal courts throughout the last century. Federal courts may only consolidate the estates of two or more debtors pursuant to 11 U.S.C. § 1123(a)(5)(c).

Furthermore, the 13th Circuit was correct in its holding that § 363(f) of the Bankruptcy Code only permits the sale of property from the estate free and clear of interests arising from *in rem* claims against the property subject to sale. It does not permit the sale of property free of interests arising from *in personam* claims against the debtor or entities liable for claims against the debtor under the doctrine of successor liability.

Finally, even if the Court concludes that § 363(f) authorizes the sale of property free of interests arising from *in personam* claims, respondents interests are still entitled to adequate protection under § 363(e) of the Bankruptcy Code. Such protection would include having their discrimination claim against CAPCO attach to the proceeds of the sale of the consolidated company.