No. 19-1004

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# In The Supreme Court of the United States

October Term, 2019

In re Tumbling Dice, Inc. et al., Debtors,

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Tumbling Dice, Inc. et al., Petitioner

v.

Under My Thumb, Inc., Respondent

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ON WRIT OF CERTIORARI

TO THE UNITED STATES COURT OF APPEALS

FOR THE THIRTEENTH CIRCUIT

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Counsel for Respondent

## Questions Presented

**I.** Whether 11 U.S.C. § 365(c)(1) permits a debtor-in-possession to assume an executory contract over the objection of the non-debtor party to such contract when applicable non-bankruptcy law excuses the non-debtor party from accepting performance from or rendering performance to an entity other than the debtor or the debtor-in-possession.

**II.** Whether, in a case where a class of claims is proposed to be impaired under a joint, multi-debtor plan, 11 U.S.C. § 1129(a)(10) requires acceptance from at least one impaired class of claims of each debtor or, alternatively, acceptance from one impaired class of claims of any one debtor.

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## Opinions Below

The opinion of the United States Court of Appeals for the Thirteenth Circuit is unpublished at *Under My Thumb, Inc. v. Tumbling Dice, Inc. et al. (In re Tumbling Dice, Inc. et al.)*, No. 18-0805 (13th Cir. Mar. 4, 2019).

## Statement of Jurisdiction

The formal statement of jurisdiction is waived pursuant to Competition Rule VIII.

## Statutory Provisions

Relevant statutory provisions are reproduced in the appendix to this brief. App., *infra*, 1a-2a.

## Statement of Facts

### I. Case Overview

This case concerns a chapter 11 bankruptcy filing by one of the largest gaming operations in the country. (R. at 4.) Tumbling Dice, Inc. ("TDI") and its affiliated debtors (collectively, the "Debtors") own and operate casino and resort properties located throughout the United States. (R. at 2.)

The collective Debtors are made up of ten entities: one holding company, Tumbling Dice, Inc. ("TDI"); its eight wholly-owned debtor-subsidiaries that each operate a luxury casino and resort ("Operating Debtors"); and Tumbling Dice Development, LLC ("Development"), a licensee for a software agreement with the respondent, Under My Thumb. (R. at 4.) The Debtors' cases were jointly administered under Bankruptcy Rule 1015(b) for the convenience of the parties and the court. (R. at 3.)

Respondent, Under My Thumb, objects to the collective Debtors' Joint Plan of Reorganization (the "Plan"), raising two issues to be considered on appeal. (R. at 3.) First, because of applicable intellectual property law, the respondent (as licensor) is excused from accepting performance from an entity other than the debtor or debtor-in-possession. (R. at 3.) Second, as an impaired creditor class of one of the Debtors, the respondent's rejection of the plan is sufficient using a "per debtor" approach, even under a joint plan. (R. at 3.)

The bankruptcy court overruled the initial objections of the respondent and approved the Plan, concluding that the Debtor, Development, could assume the licensing agreement by interpreting § 365(c)(1) of the Bankruptcy Code to include the so-called "actual test" (R. at 8-9.) The second objection was also overruled because the bankruptcy court interpreted § 1129(a)(10) to mean that, although no impaired class of creditors of Development voted in favor of the Plan,

the support of the impaired classes of other creditors was sufficient to approve the Plan. (R. at 9.) This decision was affirmed by the Bankruptcy Appellate Panel for the Thirteenth Circuit. However, the United States Court of Appeals for the Thirteenth Circuit reversed on both issues, resulting here in the Debtors' appeal to the United States Supreme Court. (R. at 3.)

## II. The Debtors enjoyed growth of their business due to the Software created by Under My Thumb

As operators of luxury casinos and resorts, the Operating Debtors run a casino loyalty program called Club Satisfaction. (R. at 4.) This program has existed for over thirty years. (R. at 4.) Loyalty programs are popular in the casino industry as a way of incentivizing and rewarding members for their patronage. (R. at 4.) The Operating Debtors "offer free and discounted nights at their hotels, . . . complimentary meals and drinks, . . . VIP seating for concerts," as well as other perks to members of Club Satisfaction. (R. at 4.)

A successful loyalty program has the potential to substantially increase profit for the casinos. Development contracted with respondent, Under My Thumb, in 2008, seeking to modernize Club Satisfaction and grow their business. (R. at 4.) Under My Thumb is a "leading software designer that specializes in customer loyalty and reservation programs for the hospitality industry." (R. at 4.)

Under My Thumb spent nearly a year and incurred great cost – about $10 million – to create the Club Satisfaction software ("Software"). (R. at 4.) Once completed, Development and Under My Thumb entered into a licensing agreement ("Agreement") granting Development a non-exclusive license to use the Software. (R. at 5.) Development's only role in the organization of Tumbling Dice, Inc. is as a party to this licensing agreement. (R. at 4.) This Agreement was a "personal and nondelegable" contract under intellectual property law, allowing only Development and its affiliated entities access and use of the Software (R. at 13.)

The Software was a huge success. The Software enabled the Debtors to track data on the habits of members – the games they play, how often they play them, and what foods and beverages they order – to encourage loyalty and increasing members' spending. (R. at 5.) The tremendous effect of the Software was illustrated by the tripled membership of Club Satisfaction, and increased spending by members. (R. at 5.) This invaluable Software developed by Under My Thumb became, and continues to be, an "essential part of the Debtor's ongoing business model." (R. at 5.)

Payment to Under My Thumb was to occur pursuant to an unsecured $7 million promissory note ("R&D Note") to reimburse for the costs of research and development, in addition to a monthly percentage fee based on the amount of spending by Club Satisfaction members. (R. at 4-5.)

## III. The collective Debtors filed for chapter 11 bankruptcy after an acquisition burdened them with an unserviceable debt load

TDI was acquired by a hedge fund, Start Me Up, Inc., through a leveraged buy-out in December 2011. (R. at 6.) As a result, "TDI and the Operating Debtors granted first priority liens on their assets to a syndicated group of lenders (the 'Lenders') in exchange for a loan in the amount of $3 billion." (R. at 6.) Development, because of its limited purpose as licensee to the Agreement, was left out of these discussions and was not required to act as a borrower or guarantor. (R. at 6.) Thus, as Development's only creditor, Under My Thumb was not consulted. (R. at 6.)

Partially due to this leveraged buy-out, TDI and the Operating Debtors were burdened with insurmountable debt, owing Lenders approximately $2.8 billion as of January 2016 when the Debtors filed for chapter 11 bankruptcy. (R. at 6.) In addition, the Debtors owed $120 million more to their unsecured creditors. (R. at 6.) At that time, Development's outstanding debt to

Under My Thumb was still $6 million (out of $7 million total owed in the R&D Note). (R. at 6.) Under My Thumb had not received required payments under the R&D Note since June 2015. (R. at 6.)

The plan support agreement ("Plan") and disclosure statement were filed in August 2016 after negotiations between the Debtors, Start Me Up, Lenders, and other stakeholders. (R. at 6.) Again, Under My Thumb was not consulted. (R. at 6.)

The Debtors did not seek substantive consolidation, but did jointly administer the cases for judicial efficiency. (R. at 18.) Jointly administering the plan resulted in one "joint" chapter 11 plan of reorganization. (R. at 6.) The Plan itself included a "non-substantive consolidation provision," explicitly stating that the Debtors were not being substantively consolidated and would remain separate and distinct entities. (R. at 7.)

## IV. Under My Thumb rejected the Plan after a risk to their copyrighted Software was disclosed

By the time Under My Thumb was presented with the Plan and disclosure statement, the company had changed hands yet again; this time, 51% of TDI's shares were acquired by a private equity group called Sympathy for the Devil ("SFD") in exchange for a $35 million investment. (R. at 7-8.) This meant the majority of the funding to the unsecured creditors would be paid by SFD, with Start Me Up funding the other $31 million. (R. at 8.) Along with the controlling shares of the company, SFD received several seats on the post-petition board of directors of TDI. (R. at 8.)

Review of the disclosure statement raised concerns for Under My Thumb. Sympathy for the Devil's portfolio of companies includes a direct competitor of Under My Thumb. (R. at 8.) This competing software company had tried and failed to replicate the Software for several years. (R. at 8.) Now, with its Software in the hands of a private equity group, Under My Thumb

raised objections. (R. at 8.) As Development's only impaired class of creditors, Under My Thumb voted to reject the plan, leaving Development with no impaired class of creditors to approve it. (R. at 8.) Although other creditor groups approved of the Plan, Under My Thumb objected, recognizing the risk to their business that SFD posed. (R. at 8.)

Two of Under My Thumb's objections are at issue on appeal. First, the assumption of the Agreement by the Debtors was impermissible under § 365(c)(1) because the Development lacked authority to assign the contract without consent. (R. at 8.) Second, considering respondent's refusal to accept the Plan, the Debtors are in violation of § 1129(a)(10) of the bankruptcy code because no impaired class of Development's creditors voted to approve. (R. at 9.)

Despite Under My Thumb's reasonable objection to the Plan, the Plan was confirmed by the bankruptcy court. (R. at 8.) The Bankruptcy Appellate Panel for the Thirteenth Circuit agreed and affirmed. (R. at 9.) The United States Court of Appeals for the Thirteenth Circuit disagreed and reversed the decision on both issues. (R. at 9.) The respondent respectfully requests this Court to affirm the decision of the United States Court of Appeals for the Thirteenth Circuit.

## Summary of the Arguments

**I.** This Court should affirm the Thirteenth Circuit Court's decision that the "hypothetical test" precludes Debtors from assuming the Agreement without the consent of Under My Thumb. The majority of Circuits hold that the meaning of § 365(c)(1) is unambiguous, and a literal reading requires application of the statute's "hypothetical test". In the present case, Under My Thumb intentionally contracted with and bargained for a non-exclusive license with Development, an agreement that was personal and nondelegable. Under § 365(c)(1), absent an absurd result or contrary legislative intent, applicable non-bankruptcy law prohibits assumption and assignment of such an executory contract, absent the creditor's consent. Here, the creditors,

Under My Thumb, did not consent to the Debtor's assumption, and the Debtors sought a forced assumption of the contract. Accordingly, the Court affirmed the Thirteenth Circuit Court's decision, applying § 365(c)(1)'s "hypothetical test" to protect Under My Thumb from a forced assumption of the contract.

**II.** Substantive consolidation determines whether the Court should apply a "per debtor" or "per plan" approach to 11 U.S.C. § 1129(a)(10). *In re* Tribune Co., 464 B.R. 126, 183 (Bankr. D. Del. 2011). Unless substantive consolidation has been motioned for and granted by the court, the statute should be interpreted as requiring a "per debtor" approach. *Id*. Therefore, because the Debtors failed to motion for substantive consolidation, the Court must apply a "per debtor" approach to 11 U.S.C. § 1129(a)(10). Meaning that for each individual debtor, at least one impaired class of claims under the plan must approve the plan. Here, no impaired class approved the plan under the Development. So the Plan should fail approval because of 11 U.S.C. § 1129(a)(10).

Second, considerations of whether to approve a substantive consolidation motion shows that, under multiple jurisdiction's tests, it would be inappropriate to order consolidation of the Debtors' assets and liabilities. Both the *Owens Corning* court, and the D.C. Circuit Court's tests, emphasized that substantive consolidation is a remedy to uphold creditors' rights. *In re* Owens Corning, 419 F.3d 195, 211 (3d Cir. 2005); *see also Eastgroup Properties v. Southern Motel Ass'n, Ltd.Eyeglasses*, 935 F.2d 245, 249-51 (11th Cir. 1991). In our case, there are few, if any, benefits to the Debtors through substantive consolidation. But, Under My Thumb would be materially harmed through consolidation because their intellectual property would be controlled by their direct competitor. Therefore, through balancing the equities of consolidation the Court cannot find consolidation to be appropriate.

## Argument

**I. 11 U.S.C. § 365(c)(1) protects a non-debtor from a debtor-in-possession assuming an executory contract over its objection when applicable non-bankruptcy law allows the non-debtor party to refuse performance or from an entity other than the debtor or the debtor-in-possession.**

***A. 11 U.S.C. § 365(c)(1) unambiguously prohibits nonconsensual assumptions and assignments of executory contracts.***

To determine a statute's plain meaning Courts first consider "the language of the statute itself." *United States v. Ron Pair Enters., Inc.,* 489 U.S. 235, 241 (1989) (citing *Landreth Timber Co. v. Landreth,* 471 U.S. 681, 685 (1985)). Thus, the question presented centers on the language of the statute:

> The trustee may not assume or assign any executory contract . . . of the debtor . . . if —
>
> (1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession . . . and
>
> (B) such party does not consent to such assumption or assignment[.]

11 U.S.C. § 365(c)(1) (2019). In scrutinizing § 365(c)(1), the Ninth Circuit concluded there is "no ambiguity in the plain statutory language." *Perlman v. Catapult Entm't., Inc.* (*In re Catapult Entm't Inc.*), 165 F.3d 747, 753 (9th Cir. 1999).

§ 365(c)(1) supplemented the Bankruptcy Code over thirty-five years ago. *In re Cardinal Indus., Inc.,* 116 B.R. 964, 978 (Bankr. S.D. Ohio 1990). Two years after its enactment, it was amended to "strik[e] 'or an assignee of such contract or lease' in subparagraph (1)(A)." H.R. Rep No. 99-554, at 24 (1986). Consequently, the Third Circuit found that this amendment "clarified Congress' original intent." *In re West Elec., Inc.,* 852 F.2d 79, n. 2 (3d Cir. 1988). Notably, § 365(c)(1) is substantively the same and has not been amended since. 11 U.S.C. § 365(c)(1) (1991).

***B. A literal reading of § 365(c)(1) is not in conflict with § 365(f).***

An unwavering principle of federal precedent commands "non-exclusive patent licenses [are] personal and non-assignable." *CFLC, Inc. v. Cadtrak Corp. (In re CFLC, Inc.),* 89 F.3d 673, 680 (9th Cir. 1996). Current federal decisions have followed this rule since it was adopted in the 1850s. *Id*. Pointedly, Chapter 11 of the Bankruptcy Code specifies that:

> "[e]xcept as provided in subsection (c) of this section, notwithstanding a provision in an executory contract . . . of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract . . . , the trustee may assign such contact . . . under paragraph (2) of this subsection."

11 U.S.C. § 365(f)(1) (2019). In chapter 11 reorganizations, non-exclusive licenses for intellectual property are "clearly established as . . . executory agreements within the meaning of § 365." *In re Catapult*, 165 F.3d at 750. The Ninth Circuit held that when pertinent "nonbankruptcy law makes an executory contract nonassignable because the identity of the nondebtor party is material, a debtor-in-possession may not assume the contract absent consent of the nondebtor party." *Id*. at 754-55. Thus, subsections 365(c) and (f) must be read together. *Magness v. The Dayton Country Club Co.* (*In re Magness*), 972 F.2d 689, 695 (6th Cir. 1992). § 365(f) includes an wide exclusion that overrides parts of the statute that ban the assignment of executory contracts. *Id*. § 365(c)(1) also includes an exclusion to § 365(f)'s, conditioning it on the applicable law as stated in § 365(c). *Id.* Thus, if applicable anti-assignment law is based "on the rationale that the identity of the contracting party is material to the agreement," then § 365(c)(1) applies and commands its literal application, and "[is] not at odds with the provisions of § 365(f)(1)." *In re Sunterra*, 361 F.3d at 266-67.

***C. The literal meaning of § 365(c)(1) requires application of its hypothetical test.***

Taking § 365(c)(1) as it is written, its "literal language . . . is thus said to establish a 'hypothetical test': a debtor-in-possession may not assume an executory contract over the

nondebtor's objection to a hypothetical third party." *In re Catapult*, 165 F.3d at 750 (emphasis added). When applied to the assumption of executory contracts in bankruptcy proceedings, the hypothetical, or "'literal test' is derived from a literal interpretation of the Statute, under which the disjunctive 'or' in § 365(c) is construed to mean what it says[:]" — a debtor-in-possession may not assume *or* assign an executory contract, absent consent of the nondebtor party. *In re Sunterra,* 361 F.3d at 262 n.8. Furthermore, "[i]t is well-established that § 365(c)'s use of the term 'trustee' includes Chapter 11 debtors in possession." *Id*. (citing *Institute Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489, 492 n.7 (1st Cir. 1997); *In re James Cable Partners, L.P.*, 27 F.3d 534, at 537 (11th Cir. 1994); *In re West Elecs.*, 852 F.2d at 82.

The Third Circuit became the first to recognize the "hypothetical test" that is found in the Statute's plain language. Confident that Congress intended a literal meaning, the Third Circuit found "11 U.S.C. § 365(c)(1) create[d] a hypothetical test." *In re West Elecs.,* 852 F.2d at 83. In 1994, the Eleventh Circuit also found that "the first condition [of § 365(c)(1)] presents a hypothetical question." *In re James Cable,* 27 F.3d at 537. Shortly after that, the Ninth Circuit joined the Third and Eleventh, holding "that [they] were bound by the plain terms of the statute[,] . . . adopting the 'hypothetical test.'" *In re Catapult Entm't*, 165 F.3d 747, 750 (9th Cir. 1999). In adopting the "hypothetical test", the Fourth Circuit also held that "the Statute may be read literally." *In re Sunterra Corp.*, 361 F.3d 257, 267 (4th Cir. 2004).

In contrast, Fifth Circuit applied the actual test, commenting that it "requires on a case-by-case basis a showing that the nondebtor party's contract will actually be assigned or that the nondebtor party will in fact be asked to accept performance from or render performance to a party — including the trustee — other than the party with who it originally contracted." *Bonneville Power Administration v. Mirant Corp., (In re Mirant Corp.)*, 440 F.3d 238, 248 (5th

Cir. 2006). However, interpretation of the statute under the "actual test" reveals that it edits out the word assume from § 365(c)(1), further straying from the unambiguous and literal meaning of § 365(c)(1). *In re Fastrax*, 129 B.R. 274, 277 (Bankr. M.D. Fla. 1991) (citing *In re Catapult*, Inc., 165 F.3d at 754).

### *D. Without extraordinary circumstances, statutes must be applied literally.*

The United States Supreme Court reminds us that it is a long-held presumption that the words in a statute are "to be used in their ordinary and usual sense, and with the meaning commonly attributed to them." *Caminetti v. United States,* 242 U.S. 470, 485-486 (1917). Additionally, "unless there is some ambiguity in the language of a statute, a court's analysis must end with the statute's plain language (the Plain Meaning Rule)." *Hilman v. Internal Revenue Serv.*, 263 F.3d 338, 342 (4th Cir. 2001) (citing *Caminetti v. United States*, 242 U.S. 470, 485 (1917)).

Absent extraordinary circumstances, The Plain Meaning Rule must be applied. *In re Sunterra*., 361 F.3d 257, 265 (4th Circ. 2004). Such circumstances have created only two pointed exceptions: absurdity and contrary legislative intent. *Id.* Thus, a literal application of the statute produces only one result: the "hypothetical test." *In re Catapult Entm't, Inc*., 165 F.3d 747, 750.

### *E. The legislative history is only examined when a statute is ambiguous, and its application produces a result in opposition to Congressional intent.*

When the Court does not "discern . . . ambiguity in the plain statutory language, [it] need not resort to legislative history." *In re Catapult Entm't, Inc*., 165 F.3d 747, 753 (9th Circ. 1999). The seldom-applied ambiguity exception to the Plain Meaning Rule permits the Court to examine the legislative intent; however, it can do so only "when literal application of the statutory language at issue produces an outcome that is demonstrably at odds with clearly

expressed congressional intent." *In re Sunterra Corp.*, 361 F.3d at 265, citing *Hillman,* 263 F.3d at 342. Additionally, this rarely used exception is only applied "where the legislative history clearly indicates that Congress meant something other than what it said." *In re Catapult Entm't, Inc.*, 165 F.3d at 753.

In conflict with the "hypothetical test," the "actual test" splices in "a narrow exception onto §365(c)(1) for debtors in possession, providing that, as to them, the statute only prohibits assumption *and* assignment, as opposed to assumption *or* assignment." *In re Catapult Entm't, Inc.*, 165 F.3d at 754. Moreover, the United States Supreme Court found that it is against a fundamental rule of statutory construction to interpret a statute in a way that "would therefore render [an] express exception insignificant, if not wholly superfluous." *TRW Inc. v. Andrews*, 534 U.S. 19, 21 (2001). Consequently, only two circuits have strayed from § 365(c)'s unambiguous and literal meaning to adopt the "actual test." Christopher B. Wick et. al., *Commercial Bankruptcy Litigation*, § 15:18 (2020).

***F. Absent an absurd result, the Court must apply the Plain Meaning Rule.***

The Plain Meaning Rule sets a prominent standard where the Court may only depart from the "plain language of [an] unambiguous statute[] . . . if the literal application of statutory language would lead to an absurd result." *Maryland State Dep't of Educ. v. U.S. Dep't of Veterans Affairs*, 98 F.3d 165, 170 (4th Cir. 1996) (citing *Crooks v. Harrelson*, 282 U.S. 55, 60 (1930)). To be absurd, it "must be so gross as to shock the general moral or common sense." *Crooks v. Harrelson*, 282 U.S. at 60. This exception sets a high bar, triggering not when the "result would be 'unreasonable,' or even 'quite unreasonable,' but [when] the result would be *absurd*." *In re Sunterra Corp.*, 361 F.3d at 268. Moreover, absurdity is non-existent "if the literal text of the statute that produces a result that is, arguably, somewhat anomalous." *Sigmon Coal*

*Co. v. Apfel*, 226 F.3d 291, 308 (4th Cir. 2000) (citing *United States v. Sheek*, 990 F.2d 150, 153 (4th Cir. 1993)).

The Fourth Circuit applied the Plain Meaning Rule to § 365(c)(1)'s "hypothetical test," finding that it did not produce an absurd result through its literal meaning. This decision, *In re Sunterra*, 361 F.3d 257 (4th Circ. 2004), involved a hospitality company that started a membership club to improve its customers' ability to trade timeshares with each other. The hospitality company entered into a non-exclusive license agreement with a software developer to create a software program, in exchange for $3.5 million, to help it manage its growing club. *Id*. at 260-61. The hospitality company spent $38 million to enhance this software and granted the software developer a license to use the improved version. *Id.* at 261. Later, the hospitality company filed for chapter 11, creating a plan to reorganize that designated itself as the debtor-in-possession of the software developer's executory contract. *Id.* at 261. The developer did not consent to the debtor-in-possession's assumption under the plan and moved for the bankruptcy court to reject the license. *Id*. at 261. The bankruptcy court found for the hospitality company, and the software developer appealed. *Id*.

The Fourth Circuit agreed with the software developer, holding that the literal meaning of § 365(c)(1)'s "hypothetical test" was not absurd when it prohibited the hospitality company from assuming the license without consent from the developer. *In re Sunterra*., 361 F.3d 257, 271 (4th Circ. 2004). The hospitality company argued that the literal meaning of § 365(c)(1) clashed with the broad policy of chapter 11 — to favor the effective reorganization of debtors. *Id.* at 267-68. This argument was unpersuasive to the Court. *Id.* at 267-68. In support of this, the court reasoned that the Code's "Nondebtor Provisions," including § 365(c)(1), was proof that Congress intended nondebtor parties to retain important rights in the reorganization process. *Id.* at 268.

Additionally, the court found that "the existence of the Nondebtor Provisions ma[de] it plausible that Congress meant what it said in the statute." *Id.* In other words, a literal reading of § 365(c)(1) "d[id] not produce a result so grossly inconsistent with bankruptcy policy as to be absurd." *Id.*

### *G. The Plain Meaning Rule requires application of the § 365(c)(1)'s "hypothetical test."*

Taken together, *Sunterra* and *Catapult* show a literal application of § 365(c)(1)'s "hypothetical test "is required under the Plain Meaning Rule. Both cases demonstrate that the bar is too high for the "hypothetical test" to produce an absurd result under the Rule. Even when a creditor's objection under § 365(c)(1) requires a debtor to lose an integral component of its business model, on top of a substantial amount of money, the Rule does not produce an absurd result. The unambiguous language of § 365(c)(1) requires its literal application, compelling adoption of its "hypothetical test."

The legislative intent behind § 365(c)(1) is a non-issue. Viewed through the lens of the Plain Meaning Rule, an analysis of the legislative history of § 365(c)(1), due to its unambiguous language, is not required. Moreover, § 365(c)(1) was enacted without a report directly used by Congress. *In re Sunterra,* 361 F.3d at 270. It follows that any effort to analyze the legislative history, as proposed by the actual test, gives meaning to "unenacted legislative intent." *Id*. Since § 365(c)(1) was enacted, Congress has watched the number of Circuits adopting the "hypothetical test" slowly overtake the body of those using the actual test. Congress appears unconcerned with the majority of Circuits' application of the literal meaning of § 365(c)(1).

Here, the "hypothetical test" as applied by the Thirteenth Circuit, did not produce an absurd result. Under My Thumb's circumstances are analogous to the software developer from *Sunterra*. Under My Thumb also develops software and entered into a non-exclusive licensing

agreement with a hospitality company to enhance their membership club. When TDI filed for chapter 11, Under My Thumb also did not consent to the assumption of its executory contract by the debtor-in-possession. Similar procedural history followed, with the Circuit Court ultimately ruling in favor of the software company. What followed was a similar procedural history as the software developer's case in *Sunterra*. In Under My Thumb's case, the Circuit Court also rejected lower courts' rulings. These striking parallels to *Sunterra* are proof that, in our case, the literal application of § 365(c)(1) is appropriate and not absurd. However, Under My Thumb has an even stronger argument that a literal reading of § 365(c)(1) is far from absurd.

Under My Thumb stands to lose far more than the creditors in *Sunterra* and *Catapult*. The post-reorganization assumption by Development positioned Under My Thumbs' direct competitor, a subsidiary of the reorganized Tumbling Dice Incorporated's majority shareholder, to have access to their intellectual property. No party would consent to an executory contract, or an assumption of the same, where it would give a direct competitor access to their intellectual property. In Under My Thumb's case, this would be the inevitable death of their business, resulting in harm to its business so great that it would significantly outweigh the nonconsensual assumption's benefit to the Debtors.[1]

Over 15 years have passed since there the Ninth Circuit Court became the fourth Circuit to adopt the "hypothetical test." In the meantime, the American Bankruptcy Institute

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[1] The A.B.I.'s Chapter 11 Report supports the Thirteenth Circuit's ruling in favor of Under My Thumb. Specifically, a recommended principle for intellectual property licenses in the report states that "[i]f the trustee seeks to assign an intellectual property license under which the debtor is a licensee to a competitor of the nondebtor licensor or an affiliate of such competitor, the court may deny the assignment if the court determines, after notice and a hearing, that the harm to the nondebtor licensor resulting from the proposed assignment significantly outweighs the benefit to the estate derived from the assignment." *See* American Bankruptcy Institute Commission to Study the Reform of Chapter 11, 2012-2014 Final Report and Recommendations 122 (2014).

recommended the adoption of the "actual test" in 2014. If Congress intended § 365(c)(1) to include the "actual test," it would have been triggered to do so by these events and amended it. As the Ninth Circuit stated, "Congress is the policy maker, not the courts." *In re Catapult Entm't Inc.*, 165 F.3d at 754. Thus, Congress's long-held silence shows us that § 365(c)(1) requires this Court to act and adopt the "hypothetical test" as Congress wrote it.

## II. 11 U.S.C. § 1129(a)(10) provides a protection for creditors against inequitable plans, requiring a plan to be accepted by at least one impaired class of claims of each debtor as separate legal entities.

### *A. Joint administration is a separate and distinct concept to substantive consolidation.*

11 U.S.C. § 1129(a)(10) requires that "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..." 11 U.S.C. § 1129(a)(10) (2010). Jurisdictions have applied two interpretations of this statute, the "per plan" and the "per debtor" approach. *In re Tribune Co*., 464 B.R. 126, 180 (Bankr. D. Del. 2011). "Per plan" means that each plan must have acceptance from one impaired class, while "per debtor" requires acceptance from one impaired class for each debtor. *Id*.

Ultimately, which approach to apply depends on if the plan has been substantively consolidated. *Id*. at 183. Substantive consolidation is the process of combining separate legal entities into one with "cumulative assets and liabilities." *In re Garden Ridge Corp*., 386 Fed.Appx. 41, 43 (3d Cir. 2010). The result shifts each creditor's claim from their debtor to "the consolidated survivor." *In re Owens Corning*, 419 F.3d 195, (3d Cir. 2005). Substantive consolidation is a legal remedy for the court to order, intending to "insure the equitable treatment of all creditors." *Eastgroup Properties v. S. Motel Ass'n. Ltd*., 935 F.2d 245, 248 (11th Cir. 1991). But, substantive consolidation is rare and requires compelling circumstances that are seldom met. *In re Owens Corning*, 419 F.3d at 210. And where substantive consolidation is not ordered, "entity separateness is fundamental." *In re Tribune Co.*, 464 B.R. at 182.

A “joint plan” may be proposed for the ease of administration; however this is quite different than substantive consolidation (i.e., joint administration does not indicate substantive consolidation). *Reider v. Fed. Deposit Ins. Corp*. (*In re Reider*), 31 F.3d 1102, 1111 (11th Cir. 1994). 11 U.S.C. § 302(b) states that “[a]fter the commencement of a joint case, the court shall determine the extent, if any, to which the debtors' estates shall be consolidated.” 11 U.S.C. § 302(b) (2011). This statute highlights that even if a plan is jointly administered, “the two estates remain separate until ordered consolidated by the court.” *In re Reider*, 31 F.3d at 1111. In essence, a joint plan still treats debtors as separate entities, but for the ease of administration each debtor institutes the same plan. *In re Tribune Co.*, 464 B.R. at 182. Therefore, if an entity has been substantively consolidated, a “per plan” approach may apply. But where there has been no substantive consolidation, a “per debtor” approach is required. *Id*. at 183

### ***B. Whether to apply a “per plan” or “per debtor” approach hinges on the existence of substantive consolidation.***

Where there is no substantive consolidation, courts have found that § 1129(a)(10) requires acceptance by impaired classes using a “per debtor” approach. To arrive at that conclusion, *In re Tribune Co.* 464 B.R. 126 (Bankr. D. Del. 2011) considered an entertainment company and some of their subsidiaries who filed for chapter 11 bankruptcy. Classes of creditors were established, and two competing reorganization plans emerged. One plan was proposed jointly by the debtors, the other by a class of creditors. The debtors never moved to consolidate their assets. In fact, both proposed plans contained “non substantive consolidation” provisions. The debtors’ plan was accepted by 39 of 111 creditors, while the creditor’s plan was accepted by only 2 of 111 impaired creditors.

The court held that neither plan satisfied the requirement under § 1129(a)(10). *Id*. at 183. The court reasoned that when there is no substantive consolidation or consent, § 1129(a)(10)

"must be satisfied by each debtor in a joint plan." *Id*. at 183. The court upheld the "per debtor" approach for two reasons. First, under the language of the statute as a whole, the other subsections require satisfaction by each debtor, so § 1129(a)(10) should be read the same. Using the plural of "plan" as read in the statute, the court reasoned that "each joint plan actually consists of a separate plan for each Debtor," allowing "non substantive consolidation" provisions to be logically consistent within the wording of the statute. *Id*. at 182. Second, jointly administered plans are common for the sake of convenience. *Id*. at 183. However, convenience is an insufficient reason to hinder an impaired class of creditors' rights. *Id*.

In our case, the Debtors' reorganization plan was only jointly administered for the sake of convenience. There was no motion for substantive consolidation, and both the Plan in our case, and the plans in *Tribune* had "non substantive consolidation" provisions. Similar to the joint plan in *Tribune*, the Debtors' plan was, in effect, separate plans for each debtor. And, as the court stated, convenience in instituting a plan is an improper reason to impair the rights of creditors. If substantive consolidation was imposed on Under My Thumb, their voting rights to refuse the Plan would be snuffed out, regardless of them being the only impaired creditor under Development. Therefore, based on the reasoning of *In re Tribune*, because the Debtors did not substantively consolidate their assets, 11 U.S.C. § 1129(a)(10) requires Under My Thumb, as the only impaired creditor of Development, to approve the plan.

### ***C. Applying the standard established in In re Owens Corning, the Court should not impose substantive consolidation in the face of cognizable harms to impaired creditors.***

In another substantive consolidation case, the United States Court of Appeals for the Third Circuit outlined factors for when substantive consolidation is an appropriate remedy. In *In re Owens Corning*, 419 F.3d 195 (3d Cir. 2005), Owens Corning (OCD) and some of their subsidiaries filed for chapter 11 reorganization from rising debts associated with asbestos

litigation. The company voted on a plan that was premised on consolidation occurring, but some creditors objected to that presupposition. The issue on review was whether substantive consolidation should be granted. The bankruptcy court ruled that the creditors did not rely on the separate credit of each subsidiary. The court concluded that substantive consolidation should be granted to "simplify and expedite" the bankruptcy process.

The Third Circuit overturned, holding that the requirements for substantive consolidation were not met. *Id.* at 212. The court's reasoning was premised on several principles that can be summarized with two considerations for substantive consolidation. *Id*. at 211. Those considerations being (1) the prepetition company significantly disregarded separateness, and their creditors relied on that disregard, treating the debtors as one legal entity, or (2) the company's assets and liabilities are so intertwined post-petition that "separating them is prohibitive and hurts all creditors." *Id*.

Applying the first consideration, the *Owens Corning* court found that OCD did not disregard entity separateness. *Id*. at 212-3. Based on the affirmative acts and statements by OCD representatives, the debtors were "fundamentally premised on an assumption of separateness." *Id*. at 213. There was also insufficient evidence to support that the creditors relied on separateness. *Id*. The court notes how, to meet the first criterion, the extension of credit must be made in reliance on the subsidiaries being distinct legal entities. *Id*. at 214. For the second consideration, the court also found that there was insufficient evidence to show that the debtors' assets were hopelessly commingled. *Id*. at 215. Post-petition, it was easy to discern the assets and liabilities of each entity. *Id*. Additionally, even if these entities were hopelessly commingled, consolidation would only be justified if separating out the entities' assets would "reduce the

recovery of *every* creditor…. Mere benefit to some creditors, or administrative benefit to the Court, falls far short." *Id*. at 214. (emphasis added).

In a recent decision, the Bankruptcy Court for the District of Delaware followed the *Owens Corning* rule for consolidation. When applying the second element, *In re Woodbridge* held that consolidation would be an equitable remedy to aid disadvantaged creditors who were taken advantage of by the debtors' Ponzi scheme. 592 B.R. 761, 778 (Bankr. D. Del. 2018). The court reasoned that it may be "literally impossible" to separate out the hopelessly commingled debtor funds, and that consolidation under these facts aligned with the *Owens Corning* principles. *Id*. at 777-78.

Read together, these cases outline specific considerations that the court should make when determining whether a motion for substantive consolidation should be granted. The *Owens Corning* principles and their fundamental considerations established guidelines for consolidation that specifically account for the equitable interests of affected creditors. That is to say, *Owens Corning* asserted that substantive consolidation should be a "defensive" remedy for creditors' identifiable harms.

In our case, the Debtors do not satisfy either of the considerations for substantive consolidation required by the *Owens Corning* court. First, while the Debtors may have disregarded separateness among their subsidiaries, Under My Thumb did not rely on that separateness, nor treat Development or any other subsidiary as one legal entity. This is evident in the Agreement — permitting Development to "extend the benefits of the Agreement to its *affiliated entities*." (R. at 5.) (emphasis added). This clause in the Agreement would be superfluous if Under My Thumb treated each debtor as one combined legal entity. If Under My Thumb treated the Debtors as one legal entity, that clause in the Agreement would not have

specifically identified the other Tumbling Dice subsidiaries as "affiliated entities." Therefore, Under My Thumb treated Development and the Operating Debtors as distinct legal entities, choosing only to contract with Development and referring to the Operating Debtors as "affiliated entities."

### ***D. The Debtors cannot be granted substantive consolidation, even under the separate standards set by the D.C. Circuit Court.***

Other courts have outlined other factors to determine when substantive consolidation is appropriate. In *Eastgroup Properties v. Southern Motel Ass'n, Ltd.Eyeglasses*, 935 F.2d 245 (11th Cir. 1991), Southern Motel Association, Ltd. (SMA) held title to motel properties. Gainesville P–H Properties' (GPH) sole business was the operation of motels that were owned or leased by SMA. Both companies were commonly owned, and had several common officers. The companies converted their chapter 11 bankruptcy filing to chapter 7, and moved to substantively consolidate their proceedings. Certain unsecured creditors objected to consolidation. The objecting unsecured creditors argued that consolidation would prejudice them because it would yield no distribution to them after claims were paid. *Id*. at 249.

The court held that substantive consolidation should be granted. *Id*. at 252. To arrive at this conclusion, the court adopted the D.C. Circuit's standard for when a motion for consolidation should be granted. *Id*. at 249. First, to establish a prima facie case for consolidation, the proponent for consolidation must show that "(1) there is substantial identity between the entities to be consolidated, and (2) consolidation is necessary to avoid some harm or to realize some benefit." *Id*. at 249. In this case, because the proponents for consolidation were able to establish their prima facie burden, the court shifted the requirement onto the objecting creditors to show "(1) it has relied on the separate credit of one of the entities to be consolidated; and (2) it will be prejudiced by substantive consolidation." *Id.* If both meet their burden, the

court may still order consolidation if the benefits heavily outweigh the harms. *Id*. Because the objecting creditors were not able to prove that they relied on the separate credit of one entity, the court decided that consolidation was appropriate. *Id*. at 251-52.

In our case, the Debtors are unable to meet the burden required to order substantive consolidation. While the Debtors may be able to meet the first element, they fail in establishing that consolidation would avoid some harm or realize some benefit. The only cognizable benefit for the Debtors is ease of administration, which is not unique to substantive consolidation. Ease of administration may be a benefit of substantive consolidation, but not a benefit that requires consolidation because joint administration realizes the same advantages without prejudicing Under My Thumb.

Even if the Court found that the Debtors would realize some benefit from substantive consolidation, Under My Thumb can show that they relied on the credit of one entity, and that they would be prejudiced by substantive consolidation. First, Under My Thumb relied solely on the credit of Development. Development was the sole entity they contracted with. Development alone would be ultimately responsible for payments under the R&D Note. Under My Thumb may have allowed Development to share its license with "affiliated entities," but clearly relied on Development to pay the reimbursement fees.

Second, Under My Thumb would be, without a doubt, severely prejudiced by substantive consolidation. Not only would they, as an impaired class of creditors, effectively have no say in the chapter 11 proceedings but would also have a direct competitor, SFD, gain access to their intellectual property. SFD, by investing $35 million, would become an affiliated entity of TDI, thereby gaining access to Under My Thumb's Software per the Agreement. This would be comparable to Burger King buying out the subsidiary of McDonalds that manufactures their

secret sauce, and subsequently granting Burger King access to the formula. It would be inequitable to McDonalds if Burger King could have unfettered access to McDonald's intellectual property through such an acquisition.

If the Court finds that both parties have established their required burdens, the Court should resolve the issue by balancing the equities for and against consolidation. Consolidation would, as stated, realize an insurmountable prejudice against Under My Thumb. The Debtors would see no cognizable benefit from consolidation as opposed to joint administration, except for the ability to block Under My Thumb from having a real say in the Plan.

Consequently, the Court should apply a "per debtor" approach to 11 U.S.C. § 1129(a)(10) because the Debtors failed to move for substantive consolidation. Additionally, even if the Court considers imposing substantive consolidation after-the-fact through applying factors and considerations laid out by multiple jurisdictions, substantive consolidation would be inequitable, and should not be forced on Under My Thumb.

## Conclusion

For the foregoing reasons, the Respondent, Under My Thumb, respectfully requests that this Court affirm the decision of the United States Court of Appeals for the Thirteenth Circuit on both issues presented.

*Respectfully Submitted,*
*#41 R*

## Appendix

**1. 11 U.S.C. § 365(c) and (f): Executory contracts and unexpired leases**

(c) The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—

(1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor-in-possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(B) such party does not consent to such assumption or assignment; or

* * * * *

(f)(1) Except as provided in subsections (b) and (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection.

(2) The trustee may assign an executory contract or unexpired lease of the debtor only if—

(A) the trustee assumes such contract or lease in accordance with the provisions of this section; and

(B) adequate assurance of future performance by the assignee of such contract or lease is provided, whether or not there has been a default in such contract or lease.

(3) Notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law that terminates or modifies, or permits a party other than the debtor to terminate or modify, such contract or lease or a right or obligation under such contract or lease on account of an assignment of such contract or lease, such contract, lease, right, or obligation may not be terminated or modified under such provision because of the assumption or assignment of such contract or lease by the trustee.

**2. 11 U.S.C. § 1129(a)(10): Confirmation of plan**

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

* * * * *

(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.

**3. 11 U.S.C. § 302(b): Joint cases**

(b) After the commencement of a joint case, the court shall determine the extent, if any, to which the debtors' estates shall be consolidated.