No. 18-957

IN THE

Supreme Court of the United States

NEXTERA ENERGY, INC.,

Petitioner,

v.

ELLIOTT ASSOCIATES, L.P., ELLIOTT INTERNATIONAL, L.P., ENERGY FUTURE HOLDINGS CORP. AND LIVERPOOL LIMITED PARTNERSHIP,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE U.S. COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF *AMICI CURIAE* OF NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether a debtor's decision to agree to a negotiated breakup fee as part of a sale transaction should be reviewed by the bankruptcy court under the deferential "business judgment rule" of 11 U.S.C. § 363, as the Fifth Circuit has held, or under the heightened standard of 11 U.S.C. § 503, which requires the bankruptcy court to decide on the debtor's behalf whether the fee is necessary, as the Third Circuit held below.

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INTEREST OF *AMICI CURIAE*

This brief is submitted on behalf of the National Association of Bankruptcy Trustees ("NABT").[1]

NABT is a nonprofit association formed in 1982 to address the needs of chapter 7 bankruptcy trustees throughout the country and to promote the effectiveness of the bankruptcy system as a whole. There are currently approximately 1,200 bankruptcy trustees receiving new cases, of whom nearly 1,000 are NABT members. NABT provides its expertise on bankruptcy issues to the United States Congress, the Office of the United States Trustee, and the Administrative Office of the United States Courts, as well as other organizations involved in bankruptcy or with the legislative process. Association leadership has testified before Congress and in administrative forums, and regularly speaks at meetings of professional organizations.

Chapter 7 trustees are fiduciaries appointed or elected to serve as representatives of chapter 7 bankruptcy estates. 11 U.S.C. §§ 323(a), 701-702. In forty-eight states and the federal territories, the United States Trustee, an official of the U.S. Department of Justice, appoints Chapter 7 "panel

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[1] Pursuant to Rule 37.2(a), amici certify that counsel of record for the parties received timely notice of the intent to file this brief and have granted consent, which is on file with the Clerk of the Court. Pursuant to Rule 37.6, amici certify that no counsel for any party authored this brief in whole or in part, no party or party's counsel made a monetary contribution to fund its preparation or submission, and no person other than amici or its counsel made such a monetary contribution.

trustees" from whom trustees in individual cases are selected. *See* 28 U.S.C. § 586(a)(1).

A Chapter 7 trustee is charged with the duty to investigate the debtor's financial affairs, collect and account for property of the estate, liquidate the property where appropriate, and close the estate. 11 U.S.C. § 704(a).

NABT has a vital interest in the issue presented here. The exercise of business judgment is an essential part of the trustee's role. That is particularly so with respect to the terms of asset sales. The sale of assets is a core part of the trustee's function. The trustee must determine whether there is non-exempt property of the estate that is worth selling to satisfy creditors after considering liens on the property, as well as taxes and litigation and other expenses that would be associated with a sale. *See* Handbook for Chapter 7 Trustees, *available at* https://www.justice.gov/ust/file/handbook_for_chapter_7_trustees.pdf/download ("Ch. 7 Handbook"), at 4-5, 4-14. If there is such property, the trustee then is charged with selling it consistent with the obligation to close a bankruptcy estate as expeditiously as is compatible with the best interests of the estate. 11 U.S.C. § 704(a)(1). As stated in the UST Handbook: "Delays in case closure diminish returns to creditors, undermine the creditors' and public's confidence in the bankruptcy system, increase the trustee's exposure to liabilities, raise the costs of administration, and, in cases involving non-dischargeable tax liabilities, expose the debtor to increased penalties and interest. Delays also give rise to public criticism of the bankruptcy process." Ch. 7 Handbook at 4-25.

Respecting the trustee's judgment in negotiating the terms of asset sales promotes the effective and efficient settlement of the estate and provides reliability and stability to the administration of the estate. Accordingly, deference to the business judgment of trustees should be the rule rather than the exception.

In addition, bankruptcy trustees have a strong interest in fostering the use of "breakup" fees where appropriate. Those fees can result in bids that would not otherwise be made, allowing the trustee to maximize the value of the estate. The decision to enter into a transaction containing a breakup fee should be left to the sound business judgment of the debtor and bankruptcy trustee.

The Third Circuit's decision here undermines these important interests. A standard that bypasses the business judgment of the debtor and trustee in favor of a "judgment call" by the bankruptcy court (Pet. App. 30a) fails to accord proper respect for the parties with the most intimate knowledge of the assets of the estate and the relevant market. Such judicial second-guessing undermines the reliability and stability of the bankruptcy process and interferes with the ability of trustees throughout the country to efficiently and cost-effectively administer Chapter 7 cases in accordance with their fiduciary mandates under the Bankruptcy Code.

This Court's plenary review is amply warranted to address the circuit conflict and promote the timely and efficient administration of bankruptcy estates.

SUMMARY OF ARGUMENT

This Court should grant the petition for certiorari to address the circuit conflict concerning the proper standard for a bankruptcy court's review of "breakup" fees as part of a sale transaction. The standard adopted by the Third Circuit, under which the bankruptcy court second guesses the judgments of the debtor and trustee in favor of its own "judgment call" based on the "totality of the circumstances," fails to accord sufficient deference to the debtor and trustee, which are the parties with the most extensive and intimate knowledge of the estate and the business needs of the debtor. The standard adopted by the Fifth Circuit more faithfully adheres to the purposes of the Bankruptcy Code and better promotes the effective and timely administration of bankruptcy estates.

Trustees are fiduciaries responsible for the efficient administration of bankruptcy cases. Trustees are carefully selected, trained, and audited, and they gain specific expertise by examining the debtor's assets and running the debtor's business. In recognition of the trustee's expertise, a fundamental premise of sales under 11 U.S.C. § 363 is deference to the trustee's business judgment.

The court of appeals' rejection of the "business judgment" test for breakup fees fails to accord sufficient respect to the trustee's expertise. The Third Circuit's approach also unnecessarily bifurcates the legal standard, taking a sale governed by the business judgment rule of section 363 and carving out one term (breakup fees) as subject to a different standard.

The ability to use breakup fees when business considerations dictate is an important component of the trustee's arsenal. Breakup fees enable the trustee to obtain an initial ("stalking horse") bid where one might not otherwise be forthcoming, thereby setting a benchmark for future bids and allowing subsequent bidders to rely on the initial bidder's due diligence. The decision to consider a breakup fee as part of an asset sale is inherently a business judgment better suited to the trustee or the debtor than to the court.

The varying approaches adopted by the courts of appeals and the bankruptcy courts undermine the stability and reliability of the bankruptcy system. Accordingly, this Court's plenary review is amply warranted.

ARGUMENT

I. Trustees Are Entitled To Deference In Their Exercise of Business Judgment.

The Third Circuit standard will undermine the important interests the Bankruptcy Code is meant to protect. The Court of Appeals replaced the considered judgment of the debtor and trustee with an open-ended "totality of the circumstances" inquiry by the bankruptcy court – one that the Third Circuit correctly characterized as a "judgment call." Pet. App. 30a. Under the Third Circuit's test, the bankruptcy court substitutes its judgment for that of the parties with the most intimate and detailed knowledge of the business (the debtor and trustee), weighs the "potential benefits to the estate" against "any potential harms," and reaches its own conclusion. *Id.* But it is precisely the analysis of potential benefits and harms – requiring predictive judgment based on extensive knowledge of the business and the market – that characterizes business judgment. The debtor and trustee are far better suited than the court to make such predictive judgments.

Congress established the current trustee system in order to ensure the competence and independence of trustees. Until 1978, bankruptcy judges appointed trustees or "referees." A Brookings study found that this led "to the appearance of political patronage in the appointment of trustees, that the quality of trustees appointed varied greatly," that trustees sometimes took actions that benefitted them at the expense of parties in interest, and that judges who appointed trustees might impartially adjudicate rights of those litigating against the trustee. Chapter 11 Trustee Handbook, *available at* https://www.justice.gov/ust/file/ch11handbook200405.pdf/download ("Ch. 11 Handbook"), at 2.

The Bankruptcy Reform Act of 1978 established the United States Trustee Program, which now operates in all judicial districts other than in North Carolina and Alabama. While bolstering the role of trustees, the 1978 Act "removed the bankruptcy judge from the responsibilities for day-to-day administration of cases." Ch. 7 Handbook at 1-1.

The United States Trustee selects panels of trustees eligible to serve in chapter 7 or chapter 11 cases. Panel members must possess qualifications set forth by the Attorney General under 28 U.S.C. § 586(d) and published at 28 C.F.R. § 58.3, as well as the requirements of section 321 of the Bankruptcy Code.

To further ensure the qualifications of trustees, the U.S. Trustee provides training to panel trustees. Ch. 7 Handbook at 6-1. The U.S. Trustee also conducts performance reviews of the panel trustees, as well as audits, field exams and case administration reviews. *Id.* at 6-2 to 6-4.

Chapter 11 trustees are selected with the input of the parties in interest. In most chapter 11 cases, current management or a creditor's committee represents the company through bankruptcy. A trustee is appointed only for cause or if the appointment would be in the best interests of creditors and other interests of the estate. 11 U.S.C. § 1104(a). When that standard is met, the U.S. Trustee consults with the parties in interest to identify the best trustee candidates. *Id.* § 1104(b)(1). Alternatively, any party in interest may request that the trustee be elected under a process set forth in the statute. 11 U.S.C. § 1104(b); Fed. R. Bankr. P. 2007.1. The trustee must be approved by the court, which is tasked with ensuring that proper consultation occurred, and that the U.S. Trustee did not abuse its discretion by appointing an unqualified or inexperienced person. *Id.* § 1104(d).

After selection, the trustee is the "representative of the estate." 11 U.S.C. § 323(a). A chapter 11 trustee "'steps into the shoes' of the debtor's management and becomes a fiduciary with an obligation of fairness to all parties in the case." Ch. 11 Handbook at 6.

In exercising day-to-day responsibilities for the administration of the estate, the trustee gains further, specific expertise about the debtor's business. The trustee investigates any fraud, incompetence, misconduct, mismanagement or irregularity in management of the affairs of the debtor. 11 U.S.C. § 1106(a)(4). The trustee presides at meetings of creditors and answers their questions. 28 U.S.C. § 586(a)(3)(E); 11 U.S.C. § 343. If the Chapter 11 trustee has been appointed prior to the meeting of creditors required by § 341, the trustee conducts an examination of the debtor to verify income, assets and other relevant matters. 11 U.S.C. § 341. In contrast, the court may not attend meetings of creditors. *Id.* § 341.

A trustee identifies, secures, and ascertains the value of assets of the estate, ensures there is adequate insurance, and implements controls to secure assets. Ch. 11 Handbook at 21; 11 U.S.C. § 1106(a)(1); *id.* § 1106(a)(3). The trustee also investigates the desirability of the continuation of the business and its form. 11 U.S.C. § 1106(a)(3). The trustee formulates and files a reorganization plan, recommends conversion of the case to one under chapter 7, 12 or 13 or recommends dismissal. *Id.* § 1106(a)(5).

During the bankruptcy process, with limited exceptions, the trustee succeeds to all property interests of the debtor, including intangible property such as a cause of action. 11 U.S.C. § 541(a). A trustee may, without court approval, take steps to void fraudulent transfers, to avoid certain liens on estate property, and to enforce decisions through adversary proceedings if necessary. 11 U.S.C. §§ 544, 545, 547, 548, 549; Fed. R. Bankr. P. 7001. The trustee may examine proofs of claims against the estate and object to any that are improper. 11 U.S.C. § 1106 (incorporating 11 U.S.C. § 704(a)(5).

Unless the court directs otherwise, the Chapter 11 trustee also operates the debtor's business during the bankruptcy process. 11 U.S.C. § 1108. In undertaking that statutory responsibility, the trustee is empowered under the Bankruptcy Code to exercise his or her business judgment daily, without any prior court approvals. *Id.* § 363(c)(1). The trustee also has discretion to assume or reject unexpired leases or executory contracts (although this discretion is subject to court approval). *Id.* § 365. The trustee makes standard purchases and sales of assets without any judicial involvement at all.

As in the Chapter 7 context, it is often important for the trustee to sell assets that the business does not routinely sell. The expertise the trustee has gained by examining and running the debtor's business is invaluable in determining whether to sell assets outside the ordinary course of business and to negotiate the best terms on which to do so. If yet more expertise is needed, a trustee, with the approval of the court, may employ professionals such as attorneys, accountants, appraisers and auctioneers to assist the trustee. 11 U.S.C. 327(a). The trustee is required to actively supervise the professionals. 28 U.S.C. § 586; 28 C.F.R. § 58.6(a)(7).

As noted, most asset sales made by the trustee are not reviewed by the bankruptcy court. However, before assets can be sold outside the ordinary course of business, there must be notice to creditors and a hearing in which any objections may be raised. 11 U.S.C. § 363(b)(1); Fed. R. Bankr. P. 2002(a)(2) and 6004(a). The difference in type of sale is often merely one of degree. The Chapter 11 Handbook offers the following example: "the ongoing sale of inventory on normal terms may be in the ordinary course of the debtor's business, but the complete liquidation of inventory at the debtor's 'going out of business' sale would generally be outside of the ordinary course of a debtor's business.'" Chapter 11 Handbook at 37.

In light of the statutory role and expertise of the trustee, a fundamental premise of sales under section 363 is deference to the trustee's business judgment. "Courts have much discretion of whether to approve proposed sales, but the trustee's business judgment is subject to great judicial deference." *In re JFD Enterprises, Inc.*, 215 F.3d 1312 (table), 2000 WL 560189 *5 (1st Cir. 2000) (internal quotations omitted); *see also In re Psychometric Systems, Inc.*, 367 B.R. 670, 674 (Bankr. D. Colo. 2007) ("[t]he trustee's business judgment is to be given 'great judicial deference'") (quoting *In re Bakalis*, 220 B.R. 525, 531-32 (Bankr. E.D.N.Y. 1998)); *In re Alaska Fishing Adventure, LLC*, 594 B.R. 883, 889-90 (Bankr. D. Alaska 2018) (same).

Thus, in evaluating proposed sales under section 363(b), the courts use a deferential business judgment standard. *See, e.g., In re ASARCO, L.L.C.,* 650 F.3d 593, 601-03 (5th Cir. 2011); *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983); *In re Allen*, 607 Fed. Appx. 840, 843 (10th Cir. 2015). That standard, which requires the trustee to articulate "sound business reasons for the sale," *In re Moreno*, 554 B.R. 504, 509-10 (Bankr. D.N.M. 2016); *see In re Moore*, 608 F.3d 253, 263 (5th Cir. 2010), appropriately accounts for the expertise of the trustee.

II. The Third Circuit's Failure To Accord Deference To A Trustee's Judgment Regarding Breakup Fees Warrants Review.

The Third Circuit did not question the application of the "business judgment" test for section 363 sales generally. But the Court of Appeals singled out one common term negotiated as part of the disposal of assets – breakup fees – for treatment under a different standard. By considering breakup fees as "administrative expenses" under 11 U.S.C. § 503(b), the Court of Appeals unduly constrains the trustee's ability to exercise his or her business judgment to dispose of estate assets.

The institutional factors that justify a deferential business judgment standard for the sale of assets apply equally to the specific terms of a contract for sale, including breakup fees. It is the trustee who has been selected for expertise to make such decision, who has met with the creditors, and who has built up the particular expertise to negotiate the terms that best serve the interests of the estate.

When a trustee agrees to a sale of estate assets, the trustee exercises business judgment with respect to the sale as a whole. But the Third Circuit's approach disrupts the process by bifurcating the legal standard: while the sale itself is subject to the business judgment rule under section 363, the Third Circuit's test singles out a specific term (any breakup fee) as if it were a separate transaction. In addition to undervaluing the trustee's expertise, the Third Circuit's standard skews the analysis of the trustee's business judgment by considering terms individually instead of evaluating the sale as a whole.

This bifurcated approach introduces uncertainty into the process and will discourage potential bidders, who now face the threat of key sale terms being eliminated one by one. The problem is even more acute when, as in this case, the term is invalidated retrospectively. It is often difficult enough to find the first bidder (*see* p. 11, *infra.*). The prospect of specific sale terms being invalidated after the fact will further discourage the stalking horse bidder and may discourage other potential purchasers as well.

The significant weakening of the degree of deference owed to the trustee by the Court of Appeals' decision warrants this Court's review.

III. Breakup Fees Perform an Important Role By Enabling Trustees to Maximize the Value of the Estate.

Respect for the business judgment of trustees is particularly important with regard to breakup fees. Breakup fees are a crucial component in a trustee's toolbox. This Court should grant review to ensure that trustees may continue to use breakup fees effectively to best serve the interests of the estate.

Breakup fees serve important purposes benefiting the estate. The first bidder in a bankruptcy auction (the so-called "stalking horse") often places itself at a distinct competitive disadvantage. As one court has noted, "the stalking horse bidder spends substantial time and money performing due diligence and negotiating an agreement," which allows subsequent bidders to "forego due diligence because they gain the required comfort from the willingness of the stalking horse bidder to enter into the proposed agreement." *In re JW Res., Inc.*, 536 B.R. 193, 196 (Bankr. E.D. Ky. 2015). Thus, "[i]t does not take a sophisticated bidder to realize that a competitor may 'piggyback' on its due diligence, valuation, and initial offer only to be outbid at the last minute." Nicholas M. McGrath, *Breaking Down Breakup Fees: The Appropriate Standard*, 2011 Ann. Surv. of Bankr. Law 14, n.3 and accompanying text (2011).

Because of the disadvantage of allowing others to benefit from the stalking horse bidder's assumption of costs and risk, inducing the first bidder to participate is essential to the process. Breakup fees allow the trustee to advance the competitive bidding process by compensating an unsuccessful bidder for taking the risk of expending (and losing) costs incurred in advancing that process. *AgriProcessors Inc. v. Fokkena* (*In re Tama Beef Packing Inc.*), 321 B.R. 496, 496-98 (B.A.P. 8th Cir. 2005). Breakup fees help the trustee start the bidding process by attracting a bid that (even if unsuccessful) will establish a benchmark for a subsequent auction and encourage more bids by allowing other bidders to rely on the due diligence of the stalking horse bidder. *See, e.g., In re JW Res., Inc.*, 536 B.R. at 196; *ASARCO*, 650 F.3d at 602 n.9 (citing *In re 310 Assocs.*, 346 F.3d 31, 34 (2d Cir. 2003)); *In re Old Cold LLC*, 879 F.3d 376 (1st Cir. 2018).

The court of appeals here recognized that breakup fees can enhance the value of the estate by promoting competitive bidding. *See* Pet. App. 29a;

In re O'Brien, 181 F.3d 527, 537 (3d Cir. 1999). But the court substantially diminished the ability of trustees to use breakup fees as a viable option by adopting a standard that creates uncertainty and substitutes its own business judgment for that of the trustee.

The analysis of a breakup fee as part of an asset sale is inherently a business judgment requiring expertise that rests with the trustee or the debtor rather than the court. Whether a proposed breakup fee is in the best interests of the estate requires consideration of factors such as whether the purchaser would likely make the bid without the breakup fee, whether the bid will induce additional bidders who can rely on the due diligence of the stalking horse, and whether the amount of the breakup fee is reasonable in light of the expected benefits from the sale. The decision thus requires seasoned judgment about the potential demand for the asset and the identity and resources of potential bidders, along with predictive judgments about how an auction for the asset will go. These are precisely the sort of factors that are best suited to the expert judgment of the trustee.

Given the expertise necessary to decide whether a breakup fee is appropriate in a given case, the Fifth Circuit's "business judgment" standard more faithfully adheres to the Bankruptcy Code's recognition of the trustee's role in the effective and efficient administration of the estate. Under the Fifth Circuit's test, the bankruptcy court maintains an important role, requiring the trustee to articulate a sound business justification for the sale that includes the breakup fee. *See ASARCO*, 650 F.3d at 601. Moreover, the business judgment standard allows the court to ensure that the transaction is free from self-dealing and to review whether the amount of the fee is reasonable relative to the purchase price. *See Allen*, 607 F. Appx. at 843. But the business decision, based on the predictive judgment that the breakup fee will enhance the bidding process and return the best value to the estate, is left to the sound judgment of the trustee or the debtor.

The Third Circuit's approach eliminates deference to the business judgment of the trustee, requiring the court to assess the breakup fee independently, as though it, rather than the trustee, were negotiating this term. And, under the Third Circuit's test, a bankruptcy court does not simply substitute its own business judgment. Instead, it applies a rigorous standard by treating the breakup fee as an "administrative expense" and thus asking whether it is a "necessary cost of preserving the estate," 11 U.S.C. § 503(b). But that standard takes the business calculation essential to the transaction out of the inquiry and substitutes a more speculative predictive judgment whether the fee will prove *necessary* when all is said and done. Courts are ill-suited to make such predictive judgments. *See Lingle v. Chevron U.S.A., Inc.*, 544 U.S. 528, 544 (2005). And when they are wrong, this will have the effect of blowing up carefully negotiated deals to the detriment of the parties in interest.

The "totality of the circumstances" approach adopted by the Third Circuit also creates uncertainty that discourages initial bidders from coming forward. Before a proposed sale is presented to the bankruptcy court for approval, the initial bidder will already have spent significant resources determining the value of the assets and formulating a bid. While potential bidders understand their proposal will require court approval, they may not wish to expend the resources to perform the due diligence necessary to develop a bid if subsequent judicial review is governed by an amorphous standard based on a "judgment call" by the court. The "business judgment" standard addresses this concern by according deference to the sound judgment of the trustee.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted.

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