No. 20-

IN THE

Supreme Court of the United States

ROBERT JAMES KEACH, Estate Representative of the Post-Effective Date Estate of Montreal, Maine, and Atlantic Railway, Ltd.,

Petitioner,

v.

NEW BRUNSWICK SOUTHERN RAILWAY COMPANY LIMITED and MAINE NORTHERN RAILWAY COMPANY,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Section 1171(b) of the Bankruptcy Code grants payment priority to unsecured claims in railroad reorganizations if such claims "would have been entitled to priority" in a federal equity receivership. 11 U.S.C. §1171(b). This provision codifies the "six months rule" established in pre-Code railroad receivership cases, which granted a special priority to certain unsecured claims of creditors that provided goods or services necessary to the railroad's operation, in reliance on payment out of the railroad's current income, in the six months before the receivership. *Fosdick* v. *Schall*, 99 U.S. 235, 252-254 (1879). Under *Fosdick*, such unsecured claims for operating expenses were entitled to priority in payment, ahead of secured creditors, only if the railroad had diverted income that should have been used to pay such claims to pay secured creditors instead. *See id.*

The question presented, on which the courts of appeals are divided, is:

Whether the "six months rule" entitles unsecured claims for necessary operating expenses incurred by a railroad in the six months before bankruptcy to priority of payment if the railroad has *not* diverted any income away from the payment of such claims to pay secured creditors.

PARTIES TO THE PROCEEDING

Petitioner is Robert James Keach, the estate representative of the post-effective date estate of Montreal, Maine & Atlantic Railway, Ltd.

Respondents are New Brunswick Southern Railway Company Limited and Maine Northern Railway Company.

CORPORATE DISCLOSURE STATEMENT

Petitioner Robert James Keach, the estate representative of the post-effective date estate of Montreal, Maine & Atlantic Railway, Ltd. ("MMA"), states that MMA has no parent corporation and no publicly held corporation owns 10% or more of its stock.

DIRECTLY RELATED PROCEEDINGS

Petitioner is unaware of any proceedings directly related to the case in this Court other than the proceedings in the courts below. For convenience, those proceedings are the following:

1. This case arises out of a Chapter 11 bankruptcy case filed in 2013 in the U.S. Bankruptcy Court for the District of Maine. *In re Montreal Maine & Atlantic Ry., Ltd.*, No. 13-10670. On February 26, 2016, the bankruptcy court entered an order holding that respondents' claims were entitled to priority under 11 U.S.C. §1171(b), but not determining the value of the claims. App. 103a-107a.

2. The Bankruptcy Appellate Panel for the U.S. Court of Appeals for the First Circuit granted leave to appeal the bankruptcy court's interlocutory order on March 29, 2016. On October 21, 2016, it entered judgment affirming the bankruptcy court's order. App. 53a-102a.

3. On remand, the bankruptcy court denied reconsideration of its February 26, 2016 order, reaffirmed that respondents' claims were entitled to priority, and determined the amounts of the claims, entering final judgment on September 6, 2018. App. 109a-117a.

4. The matter was certified for direct appeal to the U.S. Court of Appeals for the First Circuit. *Keach* v. *New Brunswick S. Ry. Co. Ltd. (In re Montreal, Maine & Atlantic Ry., Ltd.)*, No. 19-1161. The First Circuit entered judgment on March 10, 2020. App. 1a-51a. It denied rehearing on April 7, 2020. App. 119a-120a.

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PETITION FOR A WRIT OF CERTIORARI

Robert James Keach, the estate representative of the post-effective date estate of Montreal, Maine & Atlantic Railway, Ltd., respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the First Circuit.

INTRODUCTION

Chapter 11 of the Bankruptcy Code provides a mechanism for maximizing the value of a corporate debtor's assets and distributing that value equitably among the stakeholders. The fundamental principle guiding distribution in Chapter 11 is adherence to priority: Absent consent to different treatment, secured creditors are entitled to be paid in full from the value of their collateral before unsecured creditors receive any of that value; unsecured creditors with statutory priority under the Code—including creditors that provided goods and services necessary to the debtor's business during the bankruptcy case—are entitled to be paid before general unsecured creditors without such priority; and all creditors are entitled to be paid in full before equity-holders are paid anything. *See, e.g.*, *Czyzewski* v. *Jevic Holding Corp.*, 137 S. Ct. 973, 979, 983-984 (2017) ("[A] fixed priority scheme is recognized as 'the cornerstone of reorganization practice and theory.'").

This case presents a recurring question regarding the scope of an exception to that rule of fixed priority. The exception at issue, the "six months rule," originated in railroad receiverships and was made applicable to modern railroad reorganizations by the Bankruptcy Code, which provides that any unsecured claim that "would have been entitled to priority" in a receivership is entitled to priority in Chapter 11. 11 U.S.C. §1171(b). Under the six-months rule, as articulated by this Court, unsecured creditors that provided necessary goods or services to a railroad in the six months before receivership, in reliance on payment from the railroad's current income, are entitled to priority over secured creditors if the railroad diverted funds that should have been used to pay those operating expenses to pay secured creditors instead. *Fosdick* v. *Schall*, 99 U.S. 235, 252-254 (1879); *Gregg* v. *Metropolitan Trust Co.*, 197 U.S. 183, 186-188 (1905).

The question presented here—on which the courts of appeals are intractably divided—is whether the six-months rule is limited to cases in which such diversion occurred. Four courts of appeals—the Second, Sixth, Eighth, and Ninth Circuits—have so held. *In re New York, New Haven & Hartford R.R. Co.*, 405 F.2d 50, 52 (2d Cir. 1968); *New York Trust Co.* v. *Detroit, Toledo & Ironton Ry. Co.*, 251 F. 514, 522 (6th Cir. 1918); *Martin Metal Mfg. Co.* v. *United States & Mexican Trust Co.*, 225 F. 961, 964 (8th Cir. 1915); *Moore* v. *Donahoo*, 217 F. 177, 180-183, 186-187 (9th Cir. 1914).

Two courts of appeals—the First and Fourth Circuits—have held that diversion is not required. Those courts' version of the six-months rule grants priority to *all* unsecured claims for necessary operating expenses in the six months before bankruptcy, if the creditor expected payment from the railroad's current income. *In re Boston & Maine Corp.*, 634 F.2d 1359, 1377-1382 (1st Cir. 1980); *Southern Ry. Co.* v. *Flournoy*, 301 F.2d 847, 851-854 (4th Cir. 1962). In the decision below, the First Circuit expressly acknowledged this long-standing split of authority and adhered to its precedent adopting the minority position. App. 17a, 22a-25a.

The First Circuit's decision is wrong. It conflicts with this Court's precedent, which makes clear that the six-months rule applies only if funds that should have been used to pay the railroad's operating expenses were improperly diverted to pay secured creditors, and only to the extent necessary to compensate for such diversion. *Gregg*, 197 U.S. at 186-188; *Fosdick*, 99 U.S. at 252-254. It conflates the six-months rule with the separate "necessity of payment" doctrine, which allows—but does not require—payment of pre-bankruptcy unsecured claims out of estate funds when an indispensable vendor requires such payment as a condition of providing necessary goods or services to the railroad during bankruptcy (a circumstance undisputedly not presented here). *See Gregg*, 197 U.S. at 186-188 (distinguishing the two doctrines). And it expands the six-months rule, properly understood as a narrow exception to the Bankruptcy Code's fixed priority scheme, in a manner that seriously disrupts that scheme.

The First Circuit's approach also threatens significant harm to railroads and their creditors. A Chapter 11 plan of reorganization must typically pay all priority claims in full. If virtually all claims for necessary operating expenses incurred in the six months before bankruptcy are priority claims, it will be far harder for railroads to confirm a plan of reorganization, and more of them may be pushed into liquidation. Moreover, by granting priority to such claims over those of other creditors who would otherwise be entitled to better or at least equal treatment, the decision reduces those other creditors' potential recoveries in bankruptcy, making it riskier to lend to railroads and thus harder for railroads to obtain needed capital.

The First Circuit's reliance on prior circuit precedent and its denial of rehearing en banc demonstrate that the split of authority will not heal itself. And this case is an ideal vehicle for resolving the issue. The Court should grant the petition.

OPINIONS BELOW

The First Circuit's opinion (App. 1a-51a) is reported at 953 F.3d 29. The Bankruptcy Appellate Panel's opinion (App. 53a-102a) is reported at 558 B.R. 473. The bankruptcy court's orders (App. 103a-117a) are unpublished.

JURISDICTION

The First Circuit entered judgment on March 10, 2020. App. 1a. On March 24, 2020, petitioner filed a timely petition for rehearing en banc, which the court of appeals denied on April 7, 2020. App. 119a-120a. On March 19, 2020, this Court entered an order extending the time to file any petition for a writ of certiorari due after that date to 150 days from the lower court's judgment or denial of rehearing. This Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTORY PROVISION INVOLVED

Section 1171(b) of the Bankruptcy Code provides:

> Any unsecured claim against the debtor that would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the date of the order for relief under this title shall be entitled to the same priority in the case under this chapter.

11 U.S.C. §1171(b).

STATEMENT

A. Statutory Background

1. *Chapter 11 and the Bankruptcy Code's priority scheme*. The Bankruptcy Code provides an orderly process for maximizing the value of a corporate debtor's assets and distributing that value among the corporation's stakeholders. When a bankruptcy case is filed, all the debtor's interests in property become part of the bankruptcy estate. 11 U.S.C. §541(a). Creditors with claims against the debtor that arose before the bankruptcy filing—"prepetition claims"—are barred from attempting to enforce those claims against the debtor, *id.* §362(a), and can recover on their claims only through the claims-allowance and distribution process prescribed by the Code, *id.* §§501-502, 725-726, 1129.

In a Chapter 7 bankruptcy, a trustee liquidates the property in the estate and distributes the value to creditors. 11 U.S.C. §§704, 725, 726. In a Chapter 11 bankruptcy, by contrast, the aim is to reorganize the debtor and continue operation of the debtor's business after the bankruptcy case, thereby preserving the going-concern value of the business for its stakeholders. In many cases, a Chapter 11 plan will transfer ownership of the business to creditors; in others, the business may be sold to a third party and the proceeds distributed to creditors. *Id.* §§363, 1123(a)(5)(D), 1123(b)(4).

Under the Bankruptcy Code, the distribution of the estate's value to stakeholders is governed by a strict scheme of priority, which controls unless a creditor agrees to different treatment. *Czyzewski* v. *Jevic Holding Corp.*, 137 S. Ct. 973, 979, 983-984 (2017). Secured creditors are entitled to be paid first from the value of the collateral securing their claims, just as they are outside bankruptcy. 11 U.S.C. §§506, 725, 1129(b)(2)(A); *Jevic*, 137 S. Ct. at 979. Only after secured creditors have been paid in full from the value of their collateral are unsecured creditors entitled to receive any of that value. 11 U.S.C. §726(a), 1129(b)(2)(B).

Section 507 of the Bankruptcy Code singles out certain categories of unsecured claims for priority over other unsecured claims and specifies the order in which those categories of claims must be paid. 11 U.S.C. §507; *Jevic*, 137 S. Ct. at 979. For example, §507 grants second priority among unsecured claims to administrative expenses incurred during the bankruptcy case to manage the estate and operate the debtor's business. 11 U.S.C. §§507(a)(2), 503(b); *Hartford Underwriters Ins. Co.* v. *Union Planters Bank N.A.*, 530 U.S. 1, 4-5 (2000). Administrative expenses include "the value of any goods" purchased by the debtor in the ordinary course of its business within 20 days before the bankruptcy filing. 11 U.S.C. §503(b)(9). Section 507 also grants priority to certain prepetition claims for employee wages and benefits. *Id.* §507(a)(4), (5). Section 507 does not otherwise grant priority to claims for goods or services provided to the debtor before bankruptcy, even if those goods or services were necessary to the operation of the debtor's business.

To confirm a Chapter 11 plan, a debtor must pay administrative expenses and most other categories of priority claims under §507 in full on the effective date of its plan. 11 U.S.C. §1129(a)(9). Moreover, absent consent, all priority claims must be paid in full before anything may be paid to "general unsecured" claims not entitled to priority under §507. *Id.* §§726(a)(1)-(2), 1129(a)(9), 1129(b)(2)(B); *Jevic*, 137 S. Ct. at 979.

The "Bankruptcy Code aims, in the main, to secure equal distribution among creditors" with the same priority. *Howard Delivery Serv., Inc.* v. *Zurich Am. Ins. Co.*, 547 U.S. 651, 655 (2006). Accordingly, when there is insufficient value in the estate to satisfy general unsecured creditors' claims in full—which is usually the case—they receive a pro rata share of the estate's residual value (for example, each general unsecured creditor might receive 10% of the value of its allowed claim). 11 U.S.C. §§726(b), 1129(b)(2)(B). In the rare event that all general unsecured claims are paid in full, the debtor's old equity-holders may receive a distribution. *Id.* §§726(a)(6), 1129(b)(2)(C).

2. *Railroad Reorganizations.* The Bankruptcy Code contains special provisions for railroad reorganizations. 11 U.S.C. §§1161-1174. A railroad may not file a Chapter 7 bankruptcy; it can file only under Chapter

11, which permits the railroad to reorganize and continue to operate if doing so is feasible and in the public interest. 11 U.S.C. §109(b)(1), (d); *see id.* §1165. Chapter 11's goals of facilitating reorganization and maximizing value for creditors are the same for railroads as for other debtors, and most provisions of the Bankruptcy Code—including the priority scheme set out above—apply to railroads. *See id.* §1161 (identifying the few Code provisions that do not apply in railroad cases).

Railroad reorganizations differ from ordinary Chapter 11 cases in some respects, however. Among other things, railroad reorganizations require the appointment of a trustee, who may operate the railroad during the bankruptcy. 11 U.S.C. §1163. The court and trustee in a railroad reorganization are specifically instructed to "consider the public interest in addition to the interests of the debtor, creditors, and equity security holders." *Id.* §1165.

The plan of reorganization in a railroad case must specify the treatment of claims against the debtor and explain how the plan will be implemented, 11 U.S.C. §1123, as well as whether and how the railroad will continue providing rail services, *id.* §1172(a). To be confirmed, the plan must meet the same requirements as other Chapter 11 plans, including compliance with the Code's priority scheme, and must also be consistent with the public interest. *Id.* §1173(a).

3. *Section 1171(b) and the six-months rule*. Among the provisions of Chapter 11 specific to railroad reorganizations is §1171, which provides in relevant part that "[a]ny unsecured claim against the debtor that would have been entitled to priority if a receiver in equity … had been appointed by a Federal court … shall be entitled to the same priority" in the Chapter 11 case. 11

U.S.C. §1171(b). Rules of priority developed in railroad receiverships, before railroads were eligible to reorganize under the federal bankruptcy statute, thus continue to apply under the Bankruptcy Code.[1]

One such rule developed in railroad receiverships is the so-called "six months rule." Under the six-months rule, as articulated in this Court's precedent, unsecured claims for necessary goods or services provided during the six months before the receivership, in reliance on payment from the railroad's current income, were granted priority over the claims of secured creditors if the debtor diverted income that would ordinarily have been used to pay those claims to the secured creditors. *Fosdick* v. *Schall*, 99 U.S. 235, 252-254 (1879); *Gregg* v. *Metropolitan Trust Co.*, 197 U.S. 183, 186-188 (1905).

In *Fosdick*, the leading case on the six-months rule, secured lenders with a lien on all the property of a railroad foreclosed, a receiver was appointed, and the railroad's property was sold. 99 U.S. at 249. An unsecured creditor sought priority for his claim to rent for railroad cars used during the six months before the receivership, arguing that he was entitled to be paid out of the sale proceeds before the secured lenders. The Court

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[1] Railroad restructurings were handled exclusively through receivership proceedings in courts of equity until 1933, when Congress made railroads eligible to reorganize under §77 of the Bankruptcy Act of 1898. Act of March 3, 1933, 47 Stat. 1467, 1474; *see* Baird, *Elements of Bankruptcy* 59-64 (6th ed. 2014) (describing history of railroad equity receiverships); Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 Cornell L. Rev. 1420, 1440-1452 (2004) (same). Before 1978, §77 contained a sentence providing that "unsecured claims, which would have been entitled to priority if a receiver in equity … had been appointed … shall be entitled to such priority." 11 U.S.C. §205(b) (repealed 1978). The 1978 Bankruptcy Code superseded §77 but retained an almost identical sentence in §1171(b).

rejected that argument, holding that the sale proceeds "belong[] to the mortgage creditors." *Id.* at 255.

In dicta, however, the Court explained that a different result might be called for if, before the receivership, a creditor supplied the railroad with necessary goods or services, expecting payment from the railroad's current income, and the railroad instead diverted that income to the secured lenders. *Fosdick*, 99 U.S. at 252-253. In such a case, "the mortgage creditors [would] have got possession of that which in equity belonged to the whole or a part of the general creditors," justifying the receiver in "paying back … from the proceeds of the sale what [was] diverted from the current debt fund." *Id.* at 254. The Court cautioned, however, that "[w]hatever is done … must be with a view to a restoration by the mortgage creditors of that which they have thus inequitably obtained." *Id.* "[I]f there has been in reality no diversion, there can be no restoration; and … the amount of restoration should be made to depend upon the amount of the diversion." *Id.* Because no such diversion occurred in *Fosdick*, the six-months rule was inapplicable. *Id.* at 255.

This Court reiterated *Fosdick*'s rule, including the requirement of diversion, in multiple subsequent cases. *See, e.g.*, *Gregg*, 197 U.S. at 186-188; *Southern Ry. Co.* v. *Carnegie Steel Co.*, 176 U.S. 257, 274-276, 285, 293-296 (1900); *Kneeland* v. *American Loan & Trust Co.*, 136 U.S. 89, 95-97, 103 (1890); *St. Louis, Alton & Terre Haute R.R. Co.* v. *Cleveland, Cincinnati & Indianapolis Ry. Co.*, 125 U.S. 658, 673-674, 678 (1888); *Burnham* v. *Bowen*, 111 U.S. 776, 780-783 (1884).

Gregg is particularly instructive. There, an unsecured creditor delivered ties to a railroad shortly before secured lenders started foreclosure and a receiver was appointed. 197 U.S. at 186. The supplier claimed that the six-months rule entitled him to be paid ahead of the secured lenders out of the foreclosure sale proceeds—even though there had been no diversion of funds. *Id.* In an opinion by Justice Holmes, the Court rejected the supplier's attempted expansion of the six-months rule. The Court explained that there is no "general rule that such claims for supplies are entitled to precedence over a [pre-existing] lien"; to the contrary, "the general rule is the other way." *Id.* at 187. Accordingly, where "there has been no diversion of income by which the mortgagees have profited," the six-months rule is inapplicable. *Id.* at 186.

The Court distinguished *Miltenberger* v. *Logansport, Crawfordsville & Southwestern Railway Co.*, 106 U.S. 286 (1882), which the supplier claimed supported his view of the six-months rule. *Gregg*, 197 U.S. at 187. As *Gregg* explained, *Miltenberger* involved not the six-months rule, but a different rule that had developed in railroad cases, the so-called "necessity of payment" doctrine. *Id.* The necessity of payment doctrine authorized—but did not require—payment of unsecured creditors' pre-receivership claims if the creditors would otherwise stop supplying goods and services "necessary to the continued operation of the road" in receivership. *Id.* at 189*; see Miltenberger*, 106 U.S. at 311-312. As *Gregg* put it, "[t]he ground" for payment of the claims in *Miltenberger* "was not merely that the supplies [provided before the receivership] were necessary for the preservation of the road, but that the payment [of the debt] was necessary to the business of the road" continuing in receivership—"a very different proposition." 197 U.S. at 187.

Gregg thus made two things clear. First, the six-months rule articulated in *Fosdick* and the necessity of payment doctrine articulated in *Miltenberger* were distinct doctrines that differed both in scope and in rationale. 197 U.S. at 187-188. Second, the six-months rule was a narrow exception to "the general rule" that secured creditors have first priority in the proceeds of their collateral. *Id.* at 186-187. It thus applied only where "there has been [a] diversion of income" to secured lenders and away from unsecured suppliers of necessary goods and services who reasonably relied on that income for payment. *Id.*

B. Factual Background And Procedural History

1. Petitioner Robert J. Keach is the estate representative of the post-effective date estate of Montreal, Maine & Atlantic Railway, Ltd. (MMA). MMA operated a railroad in northern New England and the Canadian provinces of Québec and New Brunswick. App. 2a. In July 2013, an MMA train hauling crude oil derailed in Lac-Mégantic, Québec, resulting in explosions that killed 47 people, caused extensive property damage, and required a major environmental response. App. 8a.

Shortly thereafter, MMA filed for Chapter 11 bankruptcy in the U.S. Bankruptcy Court for the District of Maine. App. 8a. Keach was appointed as the bankruptcy trustee and operated the railroad until it was sold as a going concern to a third-party buyer in May 2014. Revised First Am. Disclosure Stmt. 37-38 (Dkt. No. 1535), *In re Montreal Maine & Atlantic Ry., Ltd.*, No. 13-10670 (Bankr. D. Me. July 16, 2015).

New Brunswick Southern Railway Company Limited and Maine Northern Railway Company, respondents here, operated rail systems that connected with MMA's lines. App. 2a-3a. In June 2014, respondents filed unsecured claims in the bankruptcy for about $2.5

million, representing respondents' claimed share of amounts MMA had collected from customers for shipping freight over MMA's and respondents' connecting lines. App. 9a. Respondents asserted that their claims were entitled to priority under the six-months rule. *Id.* Keach objected, asserting that the claims should be treated as non-priority general unsecured claims. *Id.*

In October 2015, with the parties' dispute not yet resolved, the bankruptcy court confirmed Keach's proposed Chapter 11 plan for MMA and appointed him the representative of the post-effective date MMA estate. Order Confirming Plan (Dkt. No. 1801), *In re Montreal Maine & Atlantic Ry., Ltd.*, No. 13-10670 (Bankr. D. Me. Oct. 9, 2015). The centerpiece of the plan was a settlement among numerous parties in interest that created a trust for the victims of the Lac-Mégantic derailment. *Id.* Ex. A (Plan) §§4.12, 5.1-5.16. Respondents had objected to their treatment under the plan; to resolve that objection, the confirmation order set aside over $2 million that would otherwise have gone to the derailment victims to ensure respondents' claims would be paid in full if the court ultimately determined the six-months rule applied. *Id.* ¶85.

In February 2016, the bankruptcy court held that respondents' claims qualified as six-months priority claims, but did not resolve the amount of the claims. App. 106a. Keach obtained leave to appeal the bankruptcy court's interlocutory order to the Bankruptcy Appellate Panel for the First Circuit, which affirmed. App. 102a. On remand, the bankruptcy court denied a motion for reconsideration of its February 2016 order and entered a final order reaffirming that respondents' claims were entitled to priority and determining the amount of their claims. App. 115a-116a. The parties jointly requested and were granted permission under

28 U.S.C. §158(d)(2)(A) to appeal the bankruptcy court's orders directly to the First Circuit. App. 10a.

2. The First Circuit affirmed, holding that respondents' claims were entitled to priority under the six-months rule based on the court's prior precedent interpreting that rule, *In re Boston & Maine Corp.*, 634 F.2d 1359 (1st Cir. 1980). App. 10a-25a.

The First Circuit explained that *Boston & Maine* had construed the six-months rule to encompass two independent "principles." App. 14a; *Boston & Maine*, 634 F.2d at 1377. Under the first principle, based on *Fosdick*, an unsecured creditor could "qualify for priority status" if it could show a "diversion of revenues from a current expense fund to mortgagees." App. 15a-16a; *Boston & Maine*, 634 F.2d at 1377. The First Circuit acknowledged that respondents' claims "cannot qualify as Six Months Rule claims" under the *Fosdick* principle because "no such diversion of funds occurred here." App. 14a-16a.

But *Boston & Maine* had concluded that the six-months rule also encompassed a second principle, derived from *Miltenberger*, under which no showing of diversion was required. App. 16a-17a; *Boston & Maine*, 634 F.2d at 1377-1382. *Boston & Maine* read *Miltenberger* to establish a much broader six-months rule, based on a concern over supposed "inequity in treatment" between creditors that supplied the railroad with necessary goods or services *during* bankruptcy—and thus received administrative-expense priority over other unsecured claims—and creditors that supplied such goods or services *before* bankruptcy and received no statutory priority. App. 18a-20a; *Boston & Maine*, 634 F.2d at 1380-1382. That is, *Boston & Maine* read *Miltenberger* to establish "a priority rule providing for payment of [prepetition] claims [for operating expenses] on the same basis … as [postpetition] administration expenses." App. 18a-19a; *Boston & Maine*, 634 F.2d at 1382.

Boston & Maine had accordingly held that "a claim falls within the scope of the Six Months Rule"—even absent any diversion of funds—if "(1) it represents a current operating expense necessarily incurred, (2) [it] was incurred within six months before the reorganization petition was filed, and (3) the goods or services were delivered in the expectation that they would be paid for out of current operating revenues of the railroad, and not in reliance on the road's general credit." App. 20a-21a; *Boston & Maine*, 634 F.2d at 1378.

The First Circuit acknowledged that its decision in *Boston & Maine* conflicted with the decisions of other courts of appeals, which had "read the Supreme Court's precedent to impose a *Fosdick*-based diversion requirement for claims to qualify as Six Months Rule claims." App. 24a (citing *In re New York, New Haven & Hartford R.R. Co.*, 405 F.2d 50, 52 (2d Cir. 1968)). But the panel held that it was bound "under the law-of-the-circuit doctrine … to adhere to" *Boston & Maine.* App. 24a. Applying *Boston & Maine*'s holding to this case, the First Circuit held that respondents' claims satisfied *Boston & Maine*'s three requirements and were therefore entitled to priority under the six-months rule. App. 22a-25a.[2] Keach filed a petition for rehearing en banc, which the First Circuit denied. App. 119a-120a.

[2] The First Circuit went on to reject Keach's alternative argument that respondents' claims did not in fact satisfy *Boston & Maine*'s three-part test. App. 25a-51a. Keach does not seek review of that aspect of the First Circuit's decision.

REASONS FOR GRANTING THE WRIT

I. THERE IS A SQUARE, ENTRENCHED, AND OPENLY ACKNOWLEDGED CIRCUIT SPLIT ON THE QUESTION PRESENTED

Virtually every railroad that enters bankruptcy owes money to many unsecured creditors who delivered necessary goods and services to the railroad in the six months preceding the bankruptcy filing. But the courts of appeals are in open and intractable conflict over how to handle those creditors' claims.

In the Second, Sixth, Eighth, and Ninth Circuits, such claims are treated as general unsecured claims, not entitled to priority, unless the creditors can show, as required by *Fosdick* v. *Schall*, 99 U.S. 235, 252-254 (1879), that a current debt fund was available to pay their claims but was diverted to pay the railroad's secured creditors instead. By contrast, in the First and Fourth Circuits, such claims are granted priority without any requirement of diversion of funds, so long as the creditors expected to be paid from the railroad's current income. The First Circuit below acknowledged this longstanding split of authority and reaffirmed its adherence to the minority position, further entrenching the divide among the circuits.

A. Four Circuits Have Held That The Six-Months Rule Requires A Diversion Of Funds

Of the courts of appeals that have expressly addressed the question presented, four—the Second, Sixth, Eighth, and Ninth Circuits—have held that the six-months rule requires a showing that funds that should have been used to pay unsecured operating expenses were diverted to secured creditors. These courts rely on *Fosdick* and *Gregg* v. *Metropolitan Trust*

Co., 197 U.S. 183 (1905), for the proposition that the six-months rule applies only in cases of diversion and is limited to restitution of the amount diverted.

In *In re New York, New Haven & Hartford R.R. Co.*, 405 F.2d 50 (2d Cir. 1968), for example, the Second Circuit rejected a claim for priority under the six-months rule. *Id.* at 51. Citing *Fosdick*, the court explained that "[w]hether the six months creditors receive priority depends … on whether there existed a 'current debt fund' or 'current expense fund' from which payment could have been made" to the unsecured trade creditors "but which was used instead for the benefit of" secured creditors. *Id.* at 52. The court found that there was no such "current debt fund" during the six months in question. *Id.* Accordingly, there was no diversion from a "current debt fund" to secured creditors, and the six-months rule was inapplicable. *Id.*

Likewise, in *Martin Metal Manufacturing Co.* v. *United States & Mexican Trust Co.*, 225 F. 961 (8th Cir. 1915), the Eighth Circuit refused to grant priority under the six-months rule to a claim for "supplies[] sold to the Railway Company within six months prior to the receivership," even though the supplies were "necessary for the operation of the railroad," and the claimant "expect[ed] … that its claim would be paid out of … current earnings," *id.* at 964—precisely the circumstances under which the First Circuit has held the six-months rule applicable. The Eighth Circuit explained that an unsecured claim, even for the provision of necessary goods and services, "is inferior in equity to the claims … of bondholders secured by the lien of a prior mortgage." *Id.* "It is only in the exceptional case … when current income has been diverted from the payment of current expenses" and paid to secured lenders "that such a claim may be preferred" over a secured claim, and "there was no such diversion in the case [at] hand." *Id.* The court noted that the unsecured creditor's "expectation … that its claim would be paid out of the current earnings of the Railway Company is not sufficient" to warrant priority; if it were, "liens of prior mortgages upon railroads would be idle, for nearly all general creditors undoubtedly expect payment out of the current incomes of the companies." *Id.*

Similarly, in *Moore* v. *Donahoo*, 217 F. 177 (9th Cir. 1914), the Ninth Circuit held that the six-months rule requires diversion and that the priority it affords is "limited to the amount of the income diverted." *Id.* at 180-183, 186-187. The court rejected the same argument the First Circuit has endorsed: that *Miltenberger* broadened the six-months rule beyond a remedy for diversion. *Id.* at 182. The Ninth Circuit explained that *Miltenberger* involved a different rule, the necessity of payment doctrine, which "authorized [a receiver] to pay past debts … where failure to make such payment … would make it difficult to carry on the business of[] the estate" during the receivership. *Id.* "[T]he controlling consideration" in applying the necessity of payment doctrine is whether "the receiver must pay [the] past debts before he can procure indispensable future supplies." *Id.* By contrast, as *Gregg* had "conclusively ruled," the controlling consideration under the six-months rule was whether funds had been improperly diverted. *Id.* at 181. It was not sufficient that the supplies were provided within the six-month period, that they were necessary to the operation of the railroad, and that the suppliers expected payment out of current operating income—it must also be shown that such income was diverted to secured creditors. *Id.*[3]

In *New York Trust Co.* v. *Detroit, Toledo & Ironton Railway Co.*, 251 F. 514 (6th Cir. 1918), the Sixth Circuit also held that diversion was a requirement of the six-months rule. *Id.* at 522. The court rejected a claim to priority by unsecured creditors who had delivered necessary supplies to the railroad in the six months before receivership, explaining that the creditors could not "avail themselves of the doctrine first formulated in *Fosdick* v. *Schall* … that, where there is a diversion of income, restoration of the income so diverted must be made for the payment of six months claims." *Id.* In the case at hand, the court found, "[t]here is no evidence that any such diversion occurred," and "[i]f there has in reality been no diversion, there can be no restoration" under the six-months rule. *Id.*

The Sixth Circuit had previously explained, in *International Trust Co.* v. *T.B. Townsend Brick & Contracting Co.*, 95 F. 850 (6th Cir. 1899), that "[t]he power of the court to displace mortgage liens in favor of … unsecured debts" under the six-months rule "depends upon the fact that the current income … has been diverted to the benefit of the displaced mortgage … and … is limited by the amount of the diversion." *Id.* at 860. Rejecting a broader interpretation of the six-months rule

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[3] In an earlier case, the Ninth Circuit took a different view. *See New York Guaranty & Indemnity Co.* v. *Tacoma Railway & Motor Co.*, 83 F. 365, 367 (9th Cir. 1897) (granting unsecured claim of pre-receivership supplier priority over lien because supplies were "necessary 'to keep the road a going concern'"; rejecting argument that "there must have been some diversion of income" to warrant priority). Although *Moore* did not expressly overrule *Tacoma*, it clearly held that this Court's intervening decision in *Gregg* required a showing of diversion. *Moore*, 217 F. at 181.

as a "misconception" of *Fosdick* and its progeny, the court asked: "[I]f there has been no diversion of … current income" to secured creditors, "upon what theory can the proceeds of a mortgage foreclosure sale be applied to the payment of [unsecured] debts against the objection of mortgage creditors?" *Id.* at 858, 860. "[I]s there any just or equitable reason for requiring a restoration when nothing has been improperly received? We think in such cases the court has no power to displace contract rights, and neither *Fosdick* v. *Schall* nor any of the cases which have followed it afford any sufficient authority, when rightly understood," to do so. *Id.* at 860. Notably, this Court cited *T.B. Townsend Brick* approvingly in *Gregg.* 197 U.S. at 189.[4]

B. Two Circuits, Including The First Circuit Below, Have Held That The Six-Months Rule Does Not Require A Diversion Of Funds

By contrast, the First and Fourth Circuits have adopted a minority position, holding that no showing of

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[4] The Seventh Circuit also addressed the scope of the six-months rule in *Commonwealth Edison Co.* v. *Continental National Bank & Trust of Chicago*, 93 F.2d 265 (7th Cir. 1937). The court noted that *Fosdick*'s description of the six-months rule "has been so universally recognized and approved by subsequent decisions that it is no longer open to question." *Id.* at 268. And it quoted at length *Fosdick*'s explanation that if current earnings normally used to pay unsecured operating expenses are diverted to secured creditors, it may be proper to give priority to the claims of prepetition unsecured creditors that "but for the diversion of funds, would have been paid in the ordinary course of business." *Id.* at 269 (quoting *Fosdick*, 99 U.S. at 252-253). However, the court ultimately rejected the prepetition creditor's claim to priority on the ground that it had no expectation it would be paid out of current earnings. *Id.* at 270. Accordingly, the court did not directly address the question whether a showing of diversion was required.

diversion is necessary for an unsecured creditor to be granted priority under the six-months rule.

In *Southern Railway Co.* v. *Flournoy*, 301 F.2d 847 (4th Cir. 1962), the Fourth Circuit expressly rejected the argument that the six-months rule applies "only to the extent a diversion of earnings—from the general creditors for the benefit of the mortgagees—can be demonstrated." *Id.* at 851. The Fourth Circuit construed *Miltenberger* to expand the six-months rule beyond *Fosdick*'s restitution remedy for diversion and to establish a sweeping principle that "the public interest requires that a railroad must be kept a 'going concern.'" *Id.* at 851-853. Accordingly, the court reasoned, any unsecured creditor who provided goods or services necessary to keep the railroad running in the six months before the bankruptcy, in expectation of payment out of current operating income, was entitled to priority. *Id.* The Fourth Circuit dismissed *Gregg*, opining that *Gregg* "intimated no intent to narrow *Miltenberger*." *Id.* at 852.

The Fourth Circuit's reasoning has been roundly criticized. As one court put it, "[t]he *Flournoy* court confused and merged the six months rule with … the so-called 'necessity of payment' rule … enunciated in *Miltenberger*." *In re New York, New Haven & Hartford R.R. Co.*, 278 F. Supp. 592, 602 n.15 (D. Conn. 1967), *aff'd*, 405 F.2d 50 (2d Cir. 1968). "This was directly contrary to *Gregg* … where the Supreme Court … unequivocally held that [the] necessity of payment rule's lack of a diversion requirement for corpus invasion was not to be transposed to the six months rule." *Id.*; *see also, e.g.*, *In re Penn Central Transp. Co*, 458 F. Supp. 1234, 1327 (E.D. Pa. 1978) ("[T]he *Flournoy* court simply confused the 'necessity of payment' rule with the 'six months' rule," "contrary to … *Gregg*").

Notwithstanding that criticism, in *In re Boston & Maine Corp.*, 634 F.2d 1359 (1st Cir. 1980), the First Circuit adopted the same view as the Fourth Circuit. As discussed above, *see supra* pp. 14-15, *Boston & Maine* held that the six-months rule did not require any showing of a diversion of funds. 634 F.2d at 1365-1366, 1377-1380. It read *Miltenberger* to expand the six-months rule far beyond the remedy for diversion articulated in *Fosdick*, based on the notion that all unsecured claims for goods or services necessary to a railroad's operation—whether they were provided before or after the bankruptcy filing—were entitled to equal priority. *Id.* at 1374, 1377-1380.

Below, the First Circuit acknowledged the longstanding split of authority among the courts of appeals, but adhered to the minority position it had adopted in *Boston & Maine.* App. 17a, 24a-25a. It then denied rehearing en banc, ensuring that the split will endure unless this Court intervenes.

II. THE FIRST CIRCUIT'S DECISION IS WRONG

The version of the six-months rule adopted by the First Circuit grants a wide swath of unsecured prepetition claims—which, in any other context, would be general unsecured claims without any special priority in bankruptcy—priority in railroad reorganizations even where, as here, no funds were improperly diverted away from payment of those claims to secured creditors. That holding contravenes this Court's precedent and is at war with the Bankruptcy Code's backbone priority scheme.

A. The First Circuit's Decision Contravenes This Court's Precedent

This Court has unequivocally held that the six-months rule applies only if a current debt fund that should have been used to pay unsecured operating expenses was improperly diverted to secured creditors, and only to the extent of the diversion. *See supra* pp.9-12; *Fosdick*, 99 U.S. at 252-254; *Gregg*, 197 U.S. at 186-188. This Court has also expressly held that its decision in *Miltenberger* did not expand the scope of the six-months rule. *Gregg*, 197 U.S. at 186-188. But the First Circuit effectively disregarded those holdings. Indeed, *Boston & Maine* openly relied on the *dissent* in *Gregg* to support its much broader view of the six-months rule. *Boston & Maine*, 634 F.2d at 1374. That was error.

As *Fosdick* explained, the six-months rule arose from a very specific concern: that railroads unsuccessfully seeking to avoid foreclosure would divert to secured creditors current operating income that would customarily be used to pay the unsecured claims of suppliers of necessary goods and services. 99 U.S. at 252-254. In those circumstances, *Fosdick* held that a receiver could restore the improperly diverted funds by paying such unsecured claims (if incurred in the six months before the receivership) out of foreclosure sale proceeds, ahead of the secured creditors who would normally have first priority in those proceeds. *Id.*

The key prerequisite to application of the six-months rule, *Fosdick* emphasized, is diversion: "Whatever is done … must be with a view to a restoration by the mortgage creditors of that which they have … inequitably obtained. *It follows that if there has been in reality no diversion, there can be no restoration*; and that the amount of restoration should be made to depend upon the amount of the diversion." 99 U.S. at 254 (emphasis added).

Gregg strongly reaffirmed that point, explaining that there was no "general rule" that "a claim for necessary supplies furnished within six months before the receiver was appointed" is "entitled to precedence over a lien." 197 U.S. at 186-187. Rather, "the general rule is the other way." *Id.* at 187. The six-months rule thus applies only in the exceptional case where there has been a "diversion of income by which the mortgagees have profited." *Id.* at 186.

Gregg also held that this Court's intervening decision in *Miltenberger* did not expand the six-months rule beyond cases of diversion to encompass all unsecured claims for necessary expenses incurred in the six months before the receivership. 197 U.S. at 187. Rather, under *Miltenberger*'s necessity of payment doctrine, the receiver was authorized to pay certain pre-receivership unsecured claims only where "the *payment* was necessary to the business of the road"—that is, to ensure that the creditor would continue to supply necessary goods and services to the railroad during the receivership. *Id.* (emphasis added); *see Miltenberger*, 106 U.S. at 311-312 (it may be "necessary … to the business of the road … for the receiver to pay pre-existing debts" where "a stoppage of the continuance of such [indispensable] business relations would be a probable result, in case of non-payment").

The First Circuit nonetheless held that *Miltenberger* expanded the six-months rule beyond the remedy for diversion recognized in *Fosdick*. That expanded six-months rule, according to the First Circuit, grants priority to *all* claims for "operating expenses necessarily incurred … within six months before the reorganization petition," if the creditor expected payment from current operating income. App. 16a-21a; *Boston & Maine*, 634 F.2d at 1377-1379.

To reach that conclusion, the First Circuit wrongly dismissed *Gregg*'s holding as "ambigu[ous]," *Boston & Maine*, 634 F.2d at 1378, and instead relied on the *dissent* in *Gregg*, *see id*. at 1374. The dissent had construed *Miltenberger* to ground the six-months rule on the "supreme necessity" that a railroad "be kept a going concern," and that priority under the rule thus "cannot depend upon diversion of income." 197 U.S. at 196 (McKenna, J., dissenting). Moreover, six-months priority "cannot be confined to debts contracted during the receivership," but should "extend to debts contracted before the appointment of the receiver" for equally necessary operating expenses. *Id.*

The First Circuit adopted that reasoning, opining that *Miltenberger* demonstrated that the six-months rule was "rooted" in "a concern about ensuring equal treatment" for prepetition and postpetition claims arising from the necessary costs of operating the railroad. App. 19a; *Boston & Maine*, 634 F.2d at 1377-1379. Claims for such costs incurred *during* bankruptcy are entitled to priority as administrative expenses; accordingly, the court reasoned, claims for such costs incurred *before* bankruptcy should receive the same priority. App. 19a-20a. The purpose of the six-months rule, on that view, was to "recogniz[e] administration expenses as extending backward to the period preceding reorganization," thus "eliminat[ing]" the purported "inequity in treatment" between prepetition and postpetition claims. *Boston & Maine*, 634 F.2d at 1379.

But *Miltenberger* does not support that view, and *Gregg* forecloses it. In fact, both *Miltenberger* and

Gregg emphasized that "[t]he payment of [pre-receivership] debts" under the necessity of payment doctrine "stands, prima facie, *on a different basis* from the payment of claims arising under the receivership." 106 U.S. at 311 (emphasis added); *accord Gregg*, 197 U.S. at 187.

As *Gregg* explained, the basis for paying claims for supplies delivered before the receivership in *Miltenberger* was not that "the supplies were necessary for the preservation of the road" and the supplier thus deserved the same priority of payment as creditors who provided necessary supplies during the receivership. 197 U.S. at 187. Rather, *Miltenberger* rested on the pragmatic recognition that some suppliers of essential goods or services may refuse to continue supplying the railroad in bankruptcy unless their pre-receivership claims are paid. The necessity of payment doctrine permits a receiver to pay such claims only when payment is necessary to keep the railroad operating in receivership. *Id.*; *see Miltenberger*, 106 U.S. at 311.

Gregg thus plainly rejected the First Circuit's notion that the six-months rule requires equal treatment of claims for operating expenses incurred before and after the bankruptcy—and just as plainly held that the rule is applicable only where "there has been a diversion of income" to secured creditors. 197 U.S. at 186-187. The First Circuit's ruling cannot be reconciled with either holding.

B. The First Circuit's Decision Undermines The Bankruptcy Code's Priority Scheme

The First Circuit's expanded version of the six-months rule also creates confusion and undermines the Bankruptcy Code's priority scheme.

As an initial matter, the First Circuit's decision does not specify precisely what priority six-months rule claims should be accorded. In this case, the parties reached an agreement that respondents' claims, if determined to be six-months claims, would be paid in full, *see supra* p.13, and therefore the question of how respondent's six-months claims ranked *vis-à-vis* secured claims and claims with statutory priority under §507 never had to be confronted. But the First Circuit's decision—and, in particular, its conflation of separate doctrines with distinct purposes under the rubric of the six-months rule—creates substantial confusion about how its version of the rule would apply in other cases.

Section 1171(b) does not expressly address how the priority it accords fits into the priority scheme set out in the rest of the statute, simply providing that unsecured claims "shall be entitled to the same priority" they would have in an equity receivership. 11 U.S.C. §1171(b). As originally articulated by this Court, the six-months rule granted priority to unsecured creditors over secured creditors in the proceeds of collateral, to the extent necessary to remedy any improper diversion of funds to secured creditors. *See Fosdick*, 99 U.S. at 254; *supra* pp.9-12. The First Circuit's decision to discard the diversion requirement, however, leaves the nature and scope of the six-months priority unclear. The court's "equal treatment" rationale would seem to suggest that six-months claims should have the same priority as administrative expenses under §507(a)(2), *see supra* pp.14-15, 24-25, but that is far from clear. *See* 8 *Collier on Bankruptcy* ¶1171.02 (16th ed.) (discussing the lack of clarity regarding the nature of six-months priority in light of differing interpretations of the rule). The uncertainty generated by the First Circuit's rule is itself a reason to reject that rule.

In any event, regardless of the exact priority conferred under the First Circuit's six-months rule, its decision undermines the Code's priority scheme and its bedrock principle of equality of distribution. If the decision means that unsecured prepetition claims for operating expenses have priority over secured claims, it violates one of the most fundamental aspects of priority, in and out of bankruptcy: that secured creditors have first right to the value of their collateral. Indeed, that is what it means to have a lien. Both *Fosdick* and *Gregg* recognized this point and therefore cautioned that the six-months rule, as an exception to this basic principle of priority, must be applied only to the extent necessary to remedy an improper diversion of funds away from unsecured creditors to secured creditors. The First Circuit's decision disregards this caution, granting a broad group of unsecured creditors priority based on nothing more than the vague notion that the creditors' provision of goods and services to a railroad was in the public interest. App. 15a-21a.

If the First Circuit's decision instead means that operating expenses incurred before the bankruptcy have equal priority with administrative expenses, that would be equally discordant with the Code's priority scheme. Bankruptcy law has never granted prepetition and postpetition claims the same treatment. Quite the contrary. As discussed above, *see supra* pp.6-7, the Code gives postpetition administrative expenses of the estate second priority among unsecured claims, to ensure that suppliers and other creditors will do business with the debtor even though it is in bankruptcy. 11 U.S.C. §§503(b)(1)(A), 507(a)(2). But with limited exceptions for certain employee wages and goods delivered on the eve of bankruptcy, *id.* §§503(b)(9), 507(a)(2), (4)-(5), the Code does not afford a similar priority to *prepetition* claims for the operating expenses of the debtor's business. *Id.* §§501-502, 507. Rather than being paid in full, such claims are paid their pro rata share of whatever value remains in the estate after secured and priority claims are paid. *Id.* §726(a)(2), (b); §1129(a)(9), (b)(2).

That makes sense. "Pre-filing debts are not administrative expenses; they are the antithesis of administrative expenses." *In re Kmart Corp.*, 359 F.3d 866, 872 (7th Cir. 2004). As *Kmart* explained: "Filing a petition for bankruptcy effectively creates two firms: the debts of the pre-filing entity may be written down so that the post-filing entity may reorganize and continue in business if it has a positive cash flow. Treating pre-filing debts as 'administrative' claims against the post-filing entity would impair the ability of bankruptcy law to prevent old debts from sinking a viable firm." *Id.* (citation omitted). The "inequity in treatment" between prepetition and postpetition claims that the First Circuit deprecated, *Boston & Maine*, 634 F.2d at 1380-1382, is thus a foundational premise of bankruptcy. It is a feature, not a bug.

Finally, by granting prepetition operating expenses priority over other unsecured prepetition claims in the name of equal treatment, App. 18a-20a, the First Circuit violated the very principle it claimed to vindicate. The principle of "equal distribution among creditors" requires that all unsecured prepetition claims receive the same treatment, unless "preferential treatment … is … clearly authorized by Congress." *Howard Delivery*, 547 U.S. at 655. "To give priority to a claimant not clearly entitled thereto … is … inconsistent with the policy of equality of distribution," because "[e]very claim granted priority status reduces the funds available to general unsecured creditors," as well as diluting the recoveries of the creditors Congress did intend to grant priority. *Id.* at 667. This case proves the point: The upshot of the First Circuit's decision is that respondents' unsecured prepetition claims for freight charges will be paid in full as priority claims, reducing the funds available to pay the unsecured prepetition claims of the victims of the Lac-Mégantic disaster, whose families and homes were destroyed. No bankruptcy principle justifies that result.

III. THE QUESTION IS IMPORTANT, RECURRING, AND CLEANLY PRESENTED IN THIS CASE

The First Circuit's ruling is an important one not only because it breaks with basic principles of priority and equality of distribution in bankruptcy, but also because it will have harmful consequences for the already imperiled railroad industry.

To start, the decision makes it harder for railroads that enter bankruptcy to reorganize successfully. As discussed, *see supra* pp.14-15, 22-25, the First Circuit's expansion of the six-months rule grants priority status to the vast majority of operating expenses incurred by railroads during the six months before bankruptcy. To be confirmed, a railroad's plan of reorganization must pay most priority claims in full on the plan's effective date. 11 U.S.C. §§1129(a)(9), 1129(b), 1171, 1173(a)(1)-(2). The larger the number and amount of priority claims, the more difficult an obstacle that requirement becomes. If railroads cannot confirm a plan because they cannot pay priority claims in full, they will have to liquidate. *Id.* §1174. Congress recognized that railroads provide an important public service and thus mandated that railroads reorganize and continue to operate in "the public interest" if at all feasible. *Id.*

§§1165, 1170, 1172, 1173. The First Circuit's rule undermines that key congressional purpose.

More broadly, the First Circuit's rule has the potential to affect all railroads, not just those in bankruptcy, by making it harder for railroads to raise capital. As discussed, *see supra* p.6, the Bankruptcy Code entitles secured creditors to full payment from the value of their collateral before any unsecured claims may receive a share of that value. Under the First Circuit's rule, however, a railroad could be required to pay the vast majority of unsecured claims for operating expenses during the six months before bankruptcy, before secured creditors are paid anything. As the Eighth Circuit put it, such an expansive version of the six-months rule could mean that "liens of prior mortgages upon railroads would lie idle." *Martin Metal*, 225 F. at 964. Even if six-months claims were merely given administrative-expense priority, rather than priority over secured claims—which is far from obvious—unsecured lenders and bondholders would recover less in consequence. At a minimum, the uncertainty associated with the First Circuit's decision increases both secured and unsecured lenders' risk of loss upon default and thus likely increases railroads' cost of capital. That, in turn, makes it harder for railroads to fund their capital-intensive businesses and conduct their operations safely.[5]

The question presented has generated a persistent division of authority that has lasted for decades. And

[5] *See, e.g.*, Simpson, *A Primer On The Railroad Sector*, Investopedia (July 11, 2020) ("Railroads have very high capital requirements and access to cost-effective capital is essential to their operations."), https://www.investopedia.com/articles/stocks/11/primer-on-railroad-sector.asp.

while many of the court of appeals decisions addressing the question are old, railroads still file for bankruptcy—as this case illustrates. Moreover, current economic and social conditions will likely lead to more railroad bankruptcies in the future. Railroads carry both passenger traffic and a large share of the nation's freight between cities and from ports.[6] Accordingly, railroads are highly sensitive to the business cycle, and the steep drop-off in travel demand and economic activity in response to the COVID-19 pandemic is likely to have a corresponding impact on railroads' revenues and financial conditions.[7] That trend may be exacerbated by the market collapse in oil and gas, which are often shipped by railroad. App. 6a-7a.

Railroads that have any prospect of seeking bankruptcy protection in the coming years—and the creditors of those railroads—need certainty and uniformity regarding their rights and obligations. *See* U.S. Const. art. I, §8, cl. 4 (providing for "uniform Laws on the subject of Bankruptcies throughout the United States"); *RadLAX Gateway Hotel, LLC* v. *Amalgamated Bank*, 566 U.S. 639, 649 (2012) (noting the need for "clear[]" and "predictabl[e]" interpretations of the Bankruptcy

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[6] *See* Simpson, *supra* note 5 (43% of all intercity freight transportation is handled by rail).

[7] *See* Simpson, *supra* note 5 ("Demand for rail services is a byproduct of economic activity, making railroads a cyclical business."); *2Q20 Railroad Traffic*, Bloomberg Intelligence, July 1, 2020 ("North American railroad traffic fell for the sixth straight quarter in 2Q, with declines accelerating to 18% as the pandemic sent volume to levels not seen since 2009."); *Rail Freight in the United States: May 2020*, Marketline Industry Profiles, at 9 ("Weaker revenues have been experienced as a result of falling demand for commodities such as oil and coal, which have traditionally relied on rail freight transportation.").

Code, which "standardizes an expansive (and sometimes unruly) area of law").

This case is an ideal vehicle for resolving the question presented. The First Circuit noted that it was addressing "a pure question of law." App. 10a. The parties agreed that §1171(b) incorporated the six-months rule. App. 11a. The parties, and the First Circuit, also agreed that respondents' claims qualified for priority under the six-months rule only if that rule did not require a showing of diversion of funds, since it was undisputed that "no such diversion of funds occurred here." App. 14a-16a. And the First Circuit squarely addressed the question and unequivocally endorsed the minority rule. The Court should take this opportunity to resolve the split of authority on this important question.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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APPENDICES