No. 20-310

In The
Supreme Court of the United States

ROBERT JAMES KEACH,
Estate Representative of the Post-Effective Date
Estate of Montreal Maine & 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

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Section 1171(b) of the Bankruptcy Code, 11 U.S.C. §1171(b), provides unsecured claims in a railroad reorganization case the same payment priority they would have had if an equity receiver had been appointed by a federal court on the date the railroad filed its petition for reorganization. Section 1171(b) codifies equitable principles commonly referred to as the "six months rule" which, in recognition of the public's interest in maintaining on-going rail operations, identified a subset of general unsecured claims incurred within six months prior to the commencement of a railroad receivership that were entitled to payment priority ahead of other creditors, provided that the claims arose from the furnishing of goods or services that were necessary for the continued operation of the railroad, and had been provided with the expectation of payment from the railroad's current operating revenue rather than in reliance on the railroad's general credit.

In *Fosdick v. Schall*, 99 U.S. 235, 252-254 (1879) and *Gregg v. Metropolitan Trust Co.*, 197 U.S. 183, 186-187 (1905), this Court held, on the facts presented in those cases, that six months rule claims could not be paid ahead of the claims of secured creditors, from the proceeds of the secured creditors' collateral, absent a showing of a diversion of income for the benefit of the secured creditors that could have been used to pay the six month claims. Unlike *Fosdick* and *Gregg*, however, this case does not involve a claim to payment priority

QUESTION PRESENTED – Continued

ahead of the claims of secured creditors from the proceeds of the secured creditors' collateral.

The question presented in this case, on which there is no split of authority among the courts of appeals, is:

Whether, pursuant to the "six months rule," unsecured creditors who provide goods or services essential to the continued operation of a railroad within six months prior to bankruptcy, with the expectation of payment from the railroad's current operating revenue rather than in reliance on the railroad's general credit, are entitled to payment priority ahead of other general *unsecured* creditors from assets other than proceeds of the secured creditors' collateral, without having to show any diversion of income for the benefit of the 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

Respondents, New Brunswick Southern Railway Company Limited ("NBSR") and Maine Northern Railway ("MNR"), state that:

1. The New Brunswick Railway Company, a New Brunswick corporation, is the parent corporation of NBSR, a New Brunswick corporation. No publicly held corporation owns 10% or more of the stock of NBSR or The New Brunswick Railway Company.

2. Eastern Maine Railway Company, a Maine corporation, is the parent corporation of MNR, a Delaware corporation. No publicly held corporation owns 10% or more of the stock of MNR or Eastern Maine Railway Company.

TABLE OF CONTENTS

TABLE OF CONTENTS – Continued

TABLE OF AUTHORITIES

Page

CASES

TABLE OF AUTHORITIES – Continued

Page

TABLE OF AUTHORITIES – Continued

INTRODUCTION

The question presented in this case is a simple one. Are respondents' claims arising from the prepetition provision of interline freight services to Montreal Maine & Atlantic Railway, Ltd. ("MMA") entitled under section 1171(b) of the Bankruptcy Code, 11 U.S.C. §1171(b), to payment priority as "six months rule" claims ahead of the claims of other general unsecured creditors of MMA's bankruptcy estate? The First Circuit affirmed the bankruptcy court's finding that respondents' claims qualified as six month claims because the interline freight services provided by respondents were essential to the on-going operation of the railroad, and were provided with the expectation of payment from current operating revenue, rather than in reliance upon MMA's general credit. Pet. App. 34a-51a.

This is not a case, like *Fosdick v. Schall*, 99 U.S. 235 (1879) or *Gregg v. Metropolitan Trust Co.*, 197 U.S. 183 (1905), in which payment priority was sought ahead of the claims of secured creditors, from the proceeds of the secured creditors' collateral. Indeed, petitioner's plan of liquidation in this case provided that *all* secured claims were unimpaired and would be paid first from the proceeds of the collateral securing such claims. Resp. App. 9a-15a. Moreover, petitioner's plan specifically provided that claims satisfying the requirements of section 1171(b) would be accorded priority over the claims of other general unsecured creditors, junior to non-tax priority claims "to the extent Allowed by a Final Order of the Bankruptcy Court as Claims

arising under Bankruptcy Code section 1171(b)." Resp. App. 7a-8a.

In order to resolve respondents' objection that the plan failed to accord their claims the same priority as administrative expense claims, petitioner agreed to include in the plan confirmation order a provision to set aside in excess of $2 million to secure payment of respondents' claims if they were found to satisfy the requirements for priority under section 1171(b). Order Confirming Plan, ¶85 (Dkt. No. 1801), *In re Montreal Maine & Atlantic Ry. Ltd.*, No. 13-10670 (Bankr. D. Me. Oct. 9, 2015). The bankruptcy court so found, and its findings were affirmed by the First Circuit.

The First Circuit's decision does *not* contravene *Fosdick* or *Gregg*, or any other decision of this Court addressing the six months rule. Each of those cases dealt with an entirely different question – whether six month claims were entitled to be paid ahead of the claims of secured creditors from the proceeds of the secured creditors' collateral.

Nor does the First Circuit's decision conflict with any circuit court decisions post-*Fosdick* and *Gregg* interpreting the six months rule. Each one of those cases addressed priority of payment from proceeds of the secured creditors' collateral. *In re New York, New Haven & Hartford R.R. Co.*, 405 F.2d 50 (2d Cir. 1968), *aff'g*, *In re New York, New Haven & Hartford R.R. Co.*, 278 F. Supp. 592, 595 (D. Conn. 1967) (six month claims not entitled to be paid on a priority basis from "the corpus

of the mortgaged property" of the railroad, and "unnecessary to make any further determination regarding six months claims at this time" due to lack of other available assets); *Martin Metal Mfg. Co. v. United States & Mexican Trust Co.*, 225 F. 961, 964 (8th Cir. 1915) ("[six month] claim to payment out of the corpus of railroad property, although of the *general preferential class* . . . is inferior in equity" to claims of bondholders secured by a lien against such property) (emphasis supplied); *Moore v. Donahoo*, 217 F. 177, 178 (9th Cir. 1914) ("general question involved is when and to what extent" six month claims will "be preferred to bonds secured by a pre-existing mortgage").[1]

The First Circuit's decision in this case, which affirmed the bankruptcy court's holding that respondents' claims qualified as six months rule claims entitled to priority over the claims of other general *unsecured* creditors, does not conflict with any precedent from this Court or any decisions from the United States courts of appeals, and correctly applied the priority provisions of section 1171(b) of the Bankruptcy Code

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[1] Petitioner also cites *New York Trust Co. v. Detroit, Toledo & Ironton Ry. Co.*, 251 F. 514 (6th Cir. 1918). As is true with the other cases cited by petitioner, that case is inapposite. In that case, even though the only source of payment of six month claims was the proceeds realized from the sale of mortgaged property, the supplier's six month claim was allowed, with interest, to the date of appointment of the receiver. *Id.* at 520. The issue in the case was whether the supplier could recover post-receivership interest on its claim, based upon a possible diversion of income for the benefit of the mortgage bondholders. The court held there was no evidence of diversion and thus no right to recover post-receivership interest. *Id.* at 522.

to respondents' claims. 11 U.S.C. §1171(b). The Court should deny the petition.

STATEMENT

A. Statutory and Legal Background

1. *Section 1171(b) and the Six Months Rule*. Section 1171(b) of the Bankruptcy Code provides unsecured claims in a railroad reorganization case with the same payment priority they would have had if an equity receiver had been appointed by a federal court on the date the railroad filed its petition for reorganization. *Id*. Section 1171(b) codifies principles, commonly referred to as the "six months rule," developed by the federal courts in administering equity receiverships of financially distressed railroads.[2] One of the primary drivers in the development of the rule was the public's dependence upon rail service to move passengers and freight. *Barton v. Barbour*, 104 U.S. 126, 135 (1881); *Miltenberger v. Logansport, C. & S.W. R. Co.*, 106 U.S. 286, 311-312 (1882). In recognition of the need to maintain rail operations in the public interest, courts identified a subset of general unsecured claims incurred prior to the commencement of receivership that because of their importance to on-going operations

[2] The adoption of the six months rule as a rule of priority in railroad reorganizations under federal bankruptcy law first appeared in the 1933 amendments to the Bankruptcy Act of 1898, 47 Stat. 1477, as section 77(c) of the Bankruptcy Act, 11 U.S.C. §205(c). The provision was carried over as section 77(b) in the 1935 amendments to the Bankruptcy Act, 11 U.S.C. §205(b).

were entitled to payment priority ahead of the claims of other creditors. *Id*. at 311-312. *Southern Railway Co. v. Carnegie Steel Co.*, 176 U.S. 257, 284-286 (1900); *Hale v. Frost*, 99 U.S. 389, 392 (1879).

Because the six months rule represented a departure from the general rule of equal distribution among creditors of the same class, courts recognized that the priority should be limited to exceptional claims which satisfied certain specific requirements. Over time, and as articulated in a number of decisions addressing the issue, three requirements were identified: first, the claim must have arisen from the furnishing of goods or services within six months of the commencement of the receivership; second, the goods or services must have been necessary for the continued operation of the railroad; and third, the goods or services must have been provided with the expectation of payment from the railroad's current operating revenue, rather than in reliance on the railroad's general credit. *Burnham v. Bowen*, 111 U.S. 776, 780 (1884); *Southern Railway Co. v. Carnegie Steel Co*., 176 U.S. at 285, 292; *Gregg v. Mercantile Trust Co.*, 109 F. 220, 222 (6th Cir. 1901); *In re Boston & Maine Corp.*, 634 F.2d 1359, 1378-1379 (1st Cir. 1980); *In re New York, New Haven & Hartford R.R. Co.*, 278 F. Supp. 592, 596 (D. Conn. 1967), *aff'd*, 405 F.2d 50 (2d Cir. 1968).

2. *Fosdick v. Schall*. In establishing the contours of the six months rule, courts were called upon to determine whether, under certain circumstances, the priority afforded by the rule entitled the claimant to be paid ahead of the claims of secured creditors from the

proceeds of the secured creditors' collateral (referred to as "corpus" in many of the cases) or from earnings generated by the railroad during the receivership. This Court addressed the issue in *Fosdick v. Schall*, 99 U.S. 235 (1879), involving the claim of a conditional vendor of rail cars for car rentals that had accrued within six months preceding the receivership. Finding that the only source of payment of the claim was the proceeds from the sale of mortgaged property securing the railroad's outstanding mortgage bonds, the Court held that the claimant was not entitled to be paid ahead of the bondholders absent a showing that current earnings of the railroad that could have been used to satisfy the claim had been diverted for the benefit of the bondholders. *Id*. at 252-255. Having found no such diversion, the claim could not be paid from the sale proceeds ahead of the bondholders' claims. *Id*.

3. *Miltenberger v. Logansport.* This Court had occasion to address the question again in *Miltenberger v. Logansport C. & S.W. R. Co*., 106 U.S. 286 (1882). Among the claims at issue in *Miltenberger* were interline claims of connecting carriers for unpaid freight balances that had accrued prior to the receivership. Although the receivership court had authorized the receiver to pay those claims, the issue before this Court was whether such claims, as reflected in the receiver's accounts, were *allowable* as priority claims to be paid ahead of the mortgage bondholders out of the earnings of the receivership, or, if necessary, out of the proceeds realized from the sale of the mortgaged property. In holding that the claims were entitled to priority,

the Court did not address whether there had been a diversion of income for the benefit of the bondholders, but instead emphasized the importance of the services that had been provided in maintaining the operation of the railroad in the public interest. *Id*. at 311-312. As the Court saw it: "The payment of such debts stands, prima facie, on a different basis from the payment of claims arising under the receivership, *while it may be brought within the principles of the latter by special circumstances*." *Id*. at 311 (emphasis supplied).

While *Miltenberger* is often cited as the case from which the "necessity of payment" doctrine[3] evolved, the context in which the decision was entered establishes that the Court was applying, in that case, a rule of priority. *In re Boston & Maine*, 634 F.2d at 1370 ("*Miltenberger* is concerned . . . with the more general authority of the receivership court to accord priority status to pre-receivership claims in order to prevent the stoppage of a business impressed with the public interest."). The *Miltenberger* Court reviewed a special master's examination of the receiver's accounts for purposes of determining which claims should be allowed priority. In its review, the Court addressed, among other things, claims arising from creditors' threats to withhold the supply of goods or services unless outstanding amounts owed to them were paid, and noted that:

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[3] Under the "necessity of payment" doctrine, a bankruptcy trustee or debtor in possession may be authorized to pay prepetition claims in order to secure the continued supply of goods or services considered essential to the reorganization effort.

> The report of the master shows that he *disallowed* several items in the receiver's accounts . . . where the claims were made on the ground that the creditors threatened not to furnish any more supplies on credit unless they were paid the arrears. His action, sanctioned by the court, in *allowing* items within the scope of the orders of the court, appears to have been careful, discriminating, and judicious as far as the facts can be arrived at from the record.

106 U.S. at 311 (emphasis supplied). In affirming the master's report, the Court approved the *allowance* of claims based upon six months rule priority.

4. *Gregg v. Metropolitan Trust Co.* Questions regarding the scope of six months rule priority came before this Court again in *Gregg v. Metropolitan Trust Co.*, 197 U.S. 183 (1905). In *Gregg*, the Sixth Circuit had affirmed a prior decree "*establishing [a] claim as a six months' claim*," but denying the claimant's right to recover from the "body of the fund" against which the mortgage bondholders held a first lien. 197 U.S. at 186 (emphasis supplied).[4] The Court distinguished cases in which recovery was sought from the "corpus of the fund" and those in which recovery was sought from income. With respect to the former, the Court reiterated the view it expressed in *Fosdick* that absent a

[4] The Sixth Circuit had found that the claim was for goods that were "essential" to railroad operations, purchased within six months prior to the receivership, with the "expectation that they would be paid for out of current income," and thus was "in every respect a highly meritorious" claim. *Gregg v. Mercantile Trust Co.*, 109 F. 220, 222 (6th Cir. 1901).

diversion of income by which the secured creditors had profited, six month claims were not entitled to be paid first from the proceeds of the secured creditors' collateral prior to payment of the secured creditors' claims. *Id*. at 186-188. The Court noted, however, that "the petitioner may have a claim against surplus earnings, if any, in the hands of the receiver, but that question is not before us here." *Id.* at 188.

Gregg represents this Court's last extended discussion of the application of the six months rule. Neither *Gregg*, nor any of this Court's opinions that preceded it, hold that six month claims lose their status as priority claims relative to other general unsecured claims simply because, absent a diversion of income, they are not entitled to be paid first from the proceeds of a secured creditors' collateral. The Court's recognition in *Gregg* that the status of the claims had been "established" in the proceedings below as "six months' claims" strongly suggests otherwise.[5]

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[5] Petitioner contends that *Gregg* interpreted *Miltenberger* as establishing the "necessity of payment" doctrine, rather than a rule of priority. Pet. 11. While the doctrine of necessity certainly evolved from the Court's reasoning in *Miltenberger*, the passage in *Gregg* addressing the issue actually speaks in terms of *Miltenberger's* "allowance" of priority based upon the importance of maintaining the "business" of the railroad, not just the "preservation" of its property. To that point, Justice Holmes observed that:

> The ground of such *allowance* as was made [in *Miltenberger*] was not merely that the supplies were necessary for the preservation of the road, but that the payment was necessary to the business of the road – a very different proposition. In the later cases, the wholly

5. *Circuit Court Decisions Post-Gregg*. Until the First Circuit's decision in *Boston & Maine*, none of the post-*Gregg* circuit court decisions addressing the six months rule had reason to consider the question presented in this case. In each of those cases, the question was whether the six months rule claimant could recover payment from the proceeds of the secured creditors' collateral prior to payment of the secured creditors' claims. In four of those cases, the court of appeals held that it could not, absent showing a diversion of income. *See In re New York, New Haven & Hartford R.R. Co.*, 405 F.2d 50 (2d Cir. 1968); *Martin Metal Mfg. Co. v. United States & Mexican Trust Co.*, 225 F. 961, 964 (8th Cir. 1915); *Moore v. Donahoo*, 217 F. 177, 178 (9th Cir. 1914); *New York Trust Co. v. Detroit, Toledo & Ironton Ry. Co.*, 251 F. 514, 522 (6th Cir. 1918).[6]

In one case, *Southern Railway Co. v. Flournoy*, 301 F.2d 847 (4th Cir. 1962), the Fourth Circuit held that diversion of income was not a prerequisite to payment priority from the proceeds of the secured creditors' collateral given the public interest in continued rail operations. *Id*. at 853-854. The question of the six month

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> exceptional character of the *allowance* is observed and marked.

Id. at 187 (citations omitted) (emphasis supplied). Justice Holmes was addressing *Miltenberger's* "allowance" of claims based upon the application of a rule of priority.

[6] In *New York Trust Co. v. Detroit, Toledo & Ironton*, the issue was whether the claimant could recover post-receivership interest on its claim absent a diversion of income for the benefit of the mortgage bondholders. The court held it could not. *See* note 1, *supra*.

claimant's priority over the claims of other general unsecured creditors in unencumbered assets was not addressed in any of the foregoing cases.

6. *In re Boston & Maine Corp*. The First Circuit in *Boston & Maine* undertook an extensive review of the history of the six months rule and determined that the rule had evolved from two separate, but equally applicable, principles: equitable restitution of funds diverted for the benefit of secured creditors, as articulated by this Court in *Fosdick* and *Gregg*, and principles of railroad receivership administration designed to assure the continuing provision of rail service in the public interest, as recognized by this Court in *Miltenberger*. 634 F.2d at 1382. The *Boston & Maine* court held that while a diversion of income was a prerequisite to payment priority based upon equitable restitution principles, income diversion was not required to establish priority on the basis of administrative principles governing railroad receiverships. *Id*. Those principles provide instead for:

> . . . payment of claims on the same basis and from the same operating income as administrative expenses for pre-reorganization current operating expenses that satisfy the *strict requirements of the class*, that is, that they are claims for necessary current operating expenses not furnished in reliance on the railroad's general credit.

Id. at 1382 (emphasis supplied).

Following the First Circuit's 1980 decision in *Boston & Maine*, no court of appeals has had occasion to consider the application of the six months rule until this case.

B. Factual Background and Proceedings Below

1. In July 2013, a train operated by MMA carrying crude oil en route to St. John, New Brunswick derailed in Lac-Megantic, Quebec setting off a number of explosions resulting in 47 fatalities and extensive property damage. Pet. App. 8a. Shortly thereafter, MMA filed a petition under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Maine. Petitioner, Robert J. Keach, was appointed to serve as MMA's trustee.[7] Pet. App. 8a-9a.

In June 2014, respondents, New Brunswick Southern Railway Company Limited and Maine Northern Railway Company, filed proofs of claim in MMA's bankruptcy case seeking allowance of approximately $2.1 million as priority claims under section 1171(b) of the Bankruptcy Code, 11 U.S.C. §1171(b), for interline freight services provided to MMA within six months prior to bankruptcy. Pet. App. 62a. In July 2015, Keach filed the Trustee's Revised First Amended Plan of Liquidation (Dkt. No. 1534) (the "Plan"), *In re Montreal*

[7] Following confirmation of MMA's plan of liquidation, Keach became the estate representative of MMA's post-effective date estate.

Maine & Atlantic Ry., Ltd., No. 13-10670 (Bankr. D. Me. July 16, 2015). The Plan provided that *all* secured claims were unimpaired and would be paid first from the proceeds of collateral securing such claims. Resp. App. 9a-15a. The Plan further provided that claims satisfying the requirements of section 1171(b) would be accorded priority over the claims of other general *unsecured* creditors, junior to non-tax priority claims "to the extent Allowed by a Final Order of the Bankruptcy Court as Claims arising under Bankruptcy Code section 1171(b)." Resp. App. 7a-8a.

In order to resolve respondents' objection that the Plan failed to accord their claims the same priority as administrative expense claims, Keach agreed to include in the Plan confirmation order a provision to escrow $2,139,063 to secure payment of respondents' claims if they were found to satisfy the requirements for section 1171(b) priority. Order Confirming Plan (Dkt. No. 1801, ¶85), *In re Montreal Maine & Atlantic Ry. Ltd*., No. 13-10670 (Bankr. D. Me. October 9, 2015).

Following entry of the order confirming the Plan, Keach filed objections to respondents' claims asserting that they did not qualify as six months rule claims and thus were not entitled to section 1171(b) priority. Pet. App. 9a. In February 2016, following an evidentiary hearing, the bankruptcy court held that the claims satisfied the requirements for priority as six month claims under section 1171(b), but reserved for later determination the amounts that would be allowed. Pet. App.

105a-106a. Keach obtained leave to appeal the bankruptcy court's interlocutory order to the Bankruptcy Appellate Panel for the First Circuit, which affirmed. Pet. App. 9a-10a.

On remand, following an evidentiary hearing addressing the amounts of respondents' claims, the bankruptcy court entered an order in September 2018 denying Keach's motion for reconsideration of its previous order, reaffirming that respondents' claims were valid six month claims entitled to priority under section 1171(b) of the Bankruptcy Code, and determining the allowed amount of the claims. Pet. App. 115a-116a. The parties then jointly requested, and were granted, permission under 28 U.S.C. §158(d)(2)(A) for a direct appeal of the bankruptcy court's orders to the First Circuit. Pet. App. 10a.

2. The First Circuit affirmed the bankruptcy court's holding that respondents' claims were entitled to priority under section 1171(b). The court rejected petitioner's threshold contention that it should not adhere to its previous holding in *Boston & Maine*, noting that the decision had not been "undermined by controlling authority, subsequently announced," and petitioner had failed to present *any authority* post-dating *Boston & Maine* suggesting it had been wrongly decided. Pet. App. 22a-25a.

The court explained that the key to understanding *Boston & Maine* is its recognition of the six months rule as being:

> . . . rooted in more than a concern about diversion of funds, per the *Fosdick* principle. Instead, based on the *Miltenberger* line of authority, *Boston & Maine* [] construed the Six Months Rule also to reflect a concern about ensuring equal treatment of claims that sought the recovery of payments for *expenses that were of sufficient importance to the debtor railroad to make them distinct* from claims that sought recovery for payment for the debtor railroad's less critical expenses.

Pet. App. 19a (emphasis supplied).

Boston & Maine found that the six months rule addresses this concern by recognizing that claims that satisfy the rule's stringent requirements are essentially "'indistinguishable from currently paid administration expenses' during the reorganization period," and are entitled to be treated as such. Pet. App. 19a-20a, quoting *In re Boston & Maine*, 634 F.2d at 1379. Application of the rule under these principles does not depend upon showing a diversion of income for the benefit of secured creditors. Pet. App. 20a.

Reviewing the record in the proceedings below, the First Circuit concluded that the bankruptcy court had properly found that the interline freight services provided to MMA within six months prior to bankruptcy were essential to the continued operation of the railroad, had been furnished with the expectation of payment from MMA's current operating revenue rather than in reliance on its general credit, and that respondents' claims were thus entitled to payment priority

under section 1171(b) of the Bankruptcy Code. Pet. App. 34a-51a. Keach filed a petition for rehearing en banc, which the First Circuit denied on April 7, 2020. Pet. App. 119a-120a.

REASONS FOR DENYING THE PETITION

I. THE FIRST CIRCUIT'S DECISION DOES NOT CONTRAVENE THIS COURT'S PRECEDENT OR CONFLICT WITH ANY DECISIONS OF THE COURTS OF APPEALS

Petitioner seeks to invent conflicts with prior decisions of this Court and the courts of appeals by misstating the question that is the subject of the present dispute. The question presented by this case is *not* whether respondents' claims, in the absence of a diversion of income, were entitled under the six months rule to be paid ahead of secured creditors. The question in this case is whether respondents' claims qualify for six months rule priority ahead of other general *unsecured* creditors, from assets other than the secured creditors' collateral. The First Circuit found the claims were entitled to priority because respondents had provided essential services within six months of bankruptcy, with the expectation of payment from the railroad's current operating revenue rather than in reliance on the railroad's general credit. Pet. App. 34a-51a. That decision does not contravene this Court's precedent or conflict with any decisions of the courts of appeals.

A. The First Circuit's Decision Does Not Contravene This Court's Precedent

Petitioner's contention that the First Circuit's decision contravenes this Court's decisions in *Fosdick v. Schall* and *Gregg v. Metropolitan Trust Co*. is simply incorrect. Those cases dealt with the question of whether six month claims were entitled to be paid ahead of a railroad's secured creditors from the proceeds of the secured creditors' collateral. This Court held in both cases that the claims were not entitled to payment priority ahead of secured creditors, absent a showing that income that could have been used to pay the claims had been diverted for the benefit of the secured creditors. *Fosdick*, 99 U.S. at 252-255; *Gregg*, 197 U.S. at 186-188. Neither case held, however, that a diversion of income for the benefit of secured creditors was a necessary prerequisite to the application of the six months rule in determining priority among the claims of other creditors.

Gregg is instructive on this point. In *Gregg*, the Sixth Circuit had found that a claim for goods "essential" to railroad operations, purchased within six months prior to the receivership, with the expectation of payment out of current income, was a "highly meritorious" claim, *Gregg v. Mercantile Trust Co.*, 109 F. 220, 222 (6th Cir. 1901), but denied the claimant's right to recover from the proceeds of the mortgaged property on which the bondholders held a first lien. *Gregg v. Metropolitan Trust Co.*, 124 F. 721, 722 (6th Cir. 1903). Although this Court affirmed the Sixth Circuit's denial of priority over the mortgage bondholders because

there had been no diversion of income, Justice Holmes, speaking for the Court, acknowledged the lower court's decree as "establishing this claim as a six months' claim" and noting that "petitioner may have a claim against surplus earnings, if any, in the hands of the receiver, but that question is not before us here." 197 U.S. at 186, 188. This Court did not hold in *Gregg*, and has never held, that a diversion of income for the benefit of secured creditors is a necessary prerequisite to the application of the six months rule in all cases.

B. There Is No Conflict Among the Courts of Appeals on the Question Presented by this Case

The First Circuit's decision in this case does not conflict with any courts of appeals' decisions interpreting the six months rule. Every one of those decisions, all of which pre-date the First Circuit's decision in *Boston v. Maine*, address a six month claimant's right to recover from the proceeds of a secured creditors' collateral prior to payment of the secured creditor's claim. All of them, other than *Southern Ry. Co. v. Flournoy*, 301 F.2d 847 (4th Cir. 1962), hold that no such right exists absent a diversion of income. *See In re New York, New Haven & Hartford R.R.*, 405 F.2d 50 (2d Cir. 1968)[8]; *Martin Metal Mfg. Co. v. United States &*

[8] Although not discussed in the Second Circuit's opinion in *New Haven*, the record in the district court proceedings established that the issue before the court was whether the six month claims were entitled to be paid from the proceeds of the secured creditors' collateral ahead of the secured creditors' claims. *See*

Mexican Trust Co., 225 F. 961, 964 (8th Cir. 1915); *Moore v. Donahoo*, 217 F. 177, 178 (9th Cir. 1914); *New York Trust Co. v. Detroit, Toledo & Ironton Ry. Co*., 251 F. 514, 522 (6th Cir. 1918). None of these cases address the question presented in this case – whether creditors who provide goods or services essential to the continued operation of a railroad within six months prior to bankruptcy, with the expectation of payment from the railroad's current operating revenue rather than in reliance on the railroad's general credit, are entitled to payment priority ahead of other general unsecured creditors from assets other than proceeds of the secured creditors' collateral.

That question did garner attention in the *New Haven* case, in which the district court denied the claimant's right to recover from the proceeds of the secured creditors' collateral because there had been no showing of a diversion of income, but stated that:

> If by some miracle it should develop that non-corpus assets are available, that corpus assets exceed in value the total secured debt, or that operating revenues are diverted to the mortgagees, or become so large that there are surplus earnings, *then the present claimants may, of course, renew their request for a priority*.

In re New York, New Haven & Hartford, 278 F. Supp. at 606-607 (emphasis supplied).

In re New York, New Haven & Hartford R.R. Co., 278 F. Supp. 592, 595 (D. Conn. 1967).

That statement is consistent with the view of the Second Circuit in *Pennsylvania Steel Co. v. New York City Ry.*, 216 F. 458, 470 (2d Cir. 1914), in which the court recognized the right of six month claimants to recover from unencumbered assets in the absence of a diversion of income, noting that:

> If the preference is properly rested on public policy we do not see how it can be restricted to current earnings. *Such claimants should be preferred over all general creditors*, and if current earnings are not sufficient to secure the preference it should be extended to the company's unmortgaged assets.

Id. at 471.

More fundamentally, that position comports with logic and common sense. It simply would make no sense to confer priority on a subset of unsecured claimants entitling them, under certain circumstances, to be paid ahead of secured creditors from the secured creditors' collateral, but deny them payment priority over other unsecured creditors in unencumbered assets. None of the decisions of this Court or decisions of the courts of appeals suggest such a result.

II. THE FIRST CIRCUIT CORRECTLY APPLIED THE BANKRUPTCY CODE'S PRIORITY PROVISIONS TO RESPONDENTS' CLAIMS

Petitioner complains that the First Circuit's decision undermines the Bankruptcy Code's "priority scheme" and "principle of equality of distribution." Pet.

28. Petitioner contends that if the decision "means that operating expenses incurred before the bankruptcy have equal priority with administrative expenses, that would be . . . discordant with the Code's priority scheme." *Id*. Petitioner argues also that 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." *Id*. And, finally, petitioner maintains that granting respondents' claims six months rule priority over other general unsecured claims violates the principle of "equal distribution among creditors." *Id*. at 29.

Petitioner's complaints are meritless. Congress enacted section 1171(b) of the Bankruptcy Code for the purpose of providing claims in a railroad reorganization with the same priority they would have had in a federal equity receivership. 11 U.S.C. §1171(b). That is the "priority scheme" adopted by Congress for railroad reorganizations under the Bankruptcy Code, and the First Circuit's decision in this case is faithful to it.

With respect to whether six months rule claims enjoy equal priority with administrative expense claims, petitioner acknowledges that question is not at issue in this case because the parties reached an agreement that if respondent's claims were found to be six month claims, they would be paid in full. Pet. at 27. But if it were at issue, *Miltenberger* teaches that while prebankruptcy claims against a railroad stand on a different footing from administrative expense claims, they

"may be brought within the principle of the latter by special circumstances." *Miltenberger*, 106 U.S. at 311. The First Circuit found special circumstances warranting payment priority in this case – the furnishing of essential services to the railroad within six months of bankruptcy, with the expectation of payment from current operating revenue rather than in reliance on the railroad's general credit. Its decision is in full accord with the six months rule that section 1171(b) incorporated into the Bankruptcy Code's priority scheme for railroad reorganizations.

Petitioner's contention that the First Circuit's decision violates secured creditors' rights to the value of their collateral is equally unavailing. Once again, this is not an issue implicated by the decision. There was no invasion of the secured creditors' collateral under petitioner's chapter 11 Plan to pay respondents' claims or the claims of any other creditors. There is no issue for review by this Court on that score.[9]

Finally, there is no merit to petitioner's contention that granting respondents' claims payment priority over other general unsecured claims violates the principle

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[9] Although not an issue in this case, it should be noted that there are exceptions to what petitioner characterizes as "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." Pet. 28. *See* Section 506(c) of the Bankruptcy Code, 11 U.S.C. §506(c), providing that "[t]he trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim. . . ."

of "equality of distribution." The six months rule identifies a *subset* of pre-bankruptcy general unsecured claims that are entitled to payment priority. That is beyond dispute. And petitioner concedes, as he must, that under *Fosdick* and *Gregg*, and their progeny, claims within that *subset* are entitled to payment priority out of the proceeds of a secured creditors collateral if income that could have been used to pay those claims was diverted for the benefit of the secured creditor. Unsecured creditors whose claims do not qualify under the six months rule cannot share in that recovery. To say that six month creditors lose their priority to recover from unencumbered assets if there was no diversion, and thus no ability to recover from the proceeds of the secured creditor's collateral, simply makes no sense. There is no authority to support such a result. And there is no basis to reach that conclusion in this case where funds were escrowed to pay respondents' claims if the court found that they satisfied the requirements for six months rule priority.

The First Circuit correctly applied the Bankruptcy Code's priority provisions governing the allowance of respondents' claims.

III. THIS CASE DOES NOT PRESENT AN IMPORTANT, RECURRING QUESTION THAT NEEDS TO BE RESOLVED BY THIS COURT

The best evidence that there is no important, recurring question in need of resolution by this Court is the lack of modern cases interpreting the six months

rule. Since *Boston & Maine*, which was decided 40 years ago, there have been no courts of appeals decisions addressing six month claims in a railroad bankruptcy other than the First Circuit's decision in this case.[10]

Bankruptcy and district court decisions discussing six month claims are also extremely rare. Indeed, respondents have found only one other bankruptcy court decision over the past 40 years in which the court had to decide whether a claim qualified as a six month claim. *See In re Mich. I. R. Co.*, 87 B.R. 921 (Bankr. E.D. Mich. 1988).

There also is no support for petitioner's contention that the First Circuit's decision will make it harder for railroads to reorganize successfully or increase their cost of capital. Contrary to his assertion that the First Circuit's decision will result in "grant[ing] priority status to the vast majority of operating expenses incurred by railroads during the six months before bankruptcy," Pet. 30, the stringent requirements to establish entitlement to priority under the rule effectively disqualify most creditors. Having to prove that the goods or services furnished to a railroad were "necessary" and

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[10] The Seventh Circuit mentioned six month claims, in passing, in a 1988 decision, which focused on whether certain interline freight balances constituted trust funds for connecting carriers. See *In re Iowa R. Co.*, 840 F.2d 535, 537 (7th Cir. 1988). Additionally, the Ninth Circuit held that six month claims could only be properly asserted in a railroad bankruptcy case. *See In re B & W Enters., Inc*., 713 F.2d 534, 535 (9th Cir. 1983). Neither court discussed the scope of the priority provided by the six months rule.

"essential" to on-going operations, and were provided with the expectation of payment from current operating revenue rather than in reliance on the railroad's general credit, is no small feat. That, no doubt, explains why respondents were the only creditors in MMA's reorganization case to assert and qualify for priority under the six months rule. And, respondents were only able to do so based upon unique facts involving a complex business relationship among respondents, their affiliates, and MMA. *See* Pet. App. 44a – 51a.

This case simply does not present an important recurring question that needs to be resolved by this Court.

IV. THIS CASE IS A POOR VEHICLE TO REVIEW THE QUESTION PETITIONER HAS RAISED

The crux of petitioner's argument is that priority under the six months rule is limited to providing an unsecured creditor, who otherwise satisfies the rule's requirements, only the right to be paid ahead of secured creditors from the proceeds of the secured creditors' collateral, and only if the claimant can show that the railroad diverted income that otherwise would have been available to satisfy the claim. But this is not a case in which the court granted a six month claimant the right to recover from the proceeds of secured collateral without showing a diversion of income.

The chapter 11 Plan filed by petitioner in this case provided that *all* secured claims were unimpaired and would be paid first from the proceeds of collateral

securing such claims. Resp. App. 9a-15a. Notwithstanding payment in full of all secured claims, the Plan provided that claims satisfying the requirements of section 1171(b) would be accorded priority over the claims of other general *unsecured* creditors, junior to non-tax priority claims "to the extent Allowed by a Final Order of the Bankruptcy Court as Claims arising under Bankruptcy Code section 1171(b)." *Id*. at 7a-8a. The disclosure statement filed by petitioner in conjunction with the Plan specified the requirements for determining which claims would be granted priority:

> The specific claims *protected* by section 1171(b) are referred to as "six month claims," which are claims incurred where: (i) the claim arose within six months of the filing of the petition; (ii) the obligation was incurred for a current and necessary operating expense in the ordinary course of business; and (iii) the creditor expected to be paid out of the current operating revenues of the railroad, rather than relying on the railroad's general credit.

Id. at 8a, n. 10 (emphasis supplied).

In order to resolve respondents' objection that the Plan failed to accord their claims the same priority as administrative expense claims, petitioner agreed to include in the Plan confirmation order a provision to escrow $2,139,063 to secure payment of respondents' claims if they were found to satisfy the requirements for section 1171(b) priority. Order Confirming Plan (Dkt. No. 1801, ¶85), *In re Montreal Maine & Atlantic*

Ry. Ltd., No. 13-10670 (Bankr. D. Me. October 9, 2015). The source of the escrowed funds was cash set aside under the petitioner's Plan to pay administrative and priority claims. Revised First Am. Disclosure Stmt., Exhibit C, Liquidation Analysis (Dkt. No. 1535), *In re Montreal Maine & Atlantic Ry.*, *Ltd*. No. 13-10670 (Bankr. D. Me. July 16, 2015).

Contrary to the argument he now advances, petitioner recognized in the proceedings below that priority under the six months rule is not limited to invasion of the proceeds of a secured creditors' collateral. Petitioner's Plan provided that all secured creditors would be paid first from the proceeds of their collateral. For those unsecured claims that satisfied the requirements of the six months rule, the Plan provided payment priority ahead of the claims of other unsecured creditors. The petitioner's disclosure statement identified the requirements for six months rule priority as claims (i) incurred within six months of bankruptcy, (ii) for current and necessary operating expenses, and (iii) with the expectation of payment from current operating revenue, rather than reliance on the railroad's general credit. And, to resolve respondents' objection to the Plan, petitioner agreed to include in the Plan confirmation order a provision for a $2.1 million escrow to secure payment of respondents' claims if they were found to satisfy the foregoing requirements for six months rule priority.

On the basis of this record, petitioner has waived his argument that the priority accorded six month claims over other general unsecured claims is dependent upon

a showing of income diversion. The First Circuit noted in its opinion that petitioner "repeatedly concede[d] to the Bankruptcy Court and the BAP that there was no diversion requirement under the Six Months Rule," but declined to treat his argument as waived because, in the court's view, such argument would have been futile in light of the *Boston & Maine* decision. Pet. App. 14a, note 2.

But this is more than just failing to advance an argument based upon perceived futility. In addition to providing for full payment of all secured claims, the petitioner's chapter 11 Plan (i) affirmatively provided six month claims with payment priority over other general unsecured claims from assets other than proceeds of the secured creditors' collateral, (ii) identified the specific requirements for qualifying for such priority, and (iii) escrowed the amount necessary to pay respondents' claim if they were found to satisfy such requirements. On this record, petitioner waived his right to argue that respondents' claims fail to satisfy the requirements for six months rule priority due to inability to show a diversion of income for the secured creditors benefit. *See Hamer v. Neighborhood Hous. Servs.*, 583 U.S. ___, 138 S. Ct. 13, 17 n.1 (2017) ("The terms waiver and forfeiture – though often used interchangeably by jurists and litigants – are not synonymous. Forfeiture is the failure to make the timely assertion of a right[;] waiver is the intentional relinquishment or abandonment of a known right.") (internal citations and quotation marks omitted); *United States v. Rodriguez*, 311 F.3d 435, 437 (1st Cir. 2002)

("A party waives a right when he intentionally relinquishes or abandons it.").

Moreover, petitioner's identification of the specific requirements for entitlement to six months rule priority, and his agreement to escrow funds to satisfy respondents' claims if those requirements were met, in order to achieve confirmation of his Plan, should, under principles of judicial estoppel, preclude his newly advanced diversion of income argument. *See New Hampshire v. Maine*, 532 U.S. 742, 749 (2001) ("Where a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him."); *Boston Gas Co. v. Century Indem. Co.*, 708 F.3d 254, 263 (1st Cir. 2013) (citing *Guay v. Burack*, 677 F.3d 10, 16 (1st Cir. 2012) (holding even if a party has acted in good faith it may not "assert a contradictory position simply because its interests have changed").

These additional issues, and the unique facts involved in this dispute, make this case an exceptionally poor vehicle to review a decision on which there is no split of authority among the courts of appeals, does not contravene any precedent of this Court, and involves a question that is rarely the subject of litigation.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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