No. 24-1062

In the

Supreme Court of the United States

THE HERTZ CORPORATION, et al.,

Petitioners,

v.

WELLS FARGO BANK, N.A., U.S. BANK NATIONAL ASSOCIATION,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

SUPPLEMENTAL BRIEF FOR PETITIONERS

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SUPPLEMENTAL BRIEF

The Solicitor General's brief only heightens the need for this Court's review. It squarely agrees with petitioners that the Third Circuit's absolute-priority-rule reasoning, which subordinated the Bankruptcy Code's plain text to pre-Code judicial practice, is wrong. The government nevertheless defends the bottom-line result that unmatured interest clearly disallowed by the Code must still be paid, but only by arguing that the Third Circuit made a second error. According to the government, there is no need to reach the absolute-priority issue that divided the panel below or the solvent-debtor approach adopted by the Fifth and Ninth Circuits, because a creditor is impaired *by the plan* under 11 U.S.C. §1124 even when the creditor's claim is disallowed *by the Code*. As the government concedes, that position runs counter to a "monolithic mountain of authority." *In re Ultra Petroleum Corp.*, 943 F.3d 758, 760 (5th Cir. 2019). The government—and not the monolithic mountain—is wrong. But if the government were right, it would mean that every court of appeals is approaching this recurring issue incorrectly and would only confirm the pressing need for this Court to grant certiorari and clarify the law.

The government's efforts to deny the importance of this issue are unpersuasive. As the panel majority itself recognized, its absolute-priority reasoning squarely conflicts with the Second Circuit's approach and departs from the reasoning of the Fifth and Ninth Circuits (not to mention the persuasive dissents of Judges Ikuta, Oldham, and Porter). Worse still, the panel majority laid the blame for its atextual approach on this Court's doorstep. Finally, the government's claim that the question arises infrequently cannot be squared with the reality that it keeps arising in nine-figure disputes in which no two courts (or now the government) can agree on how to evade the result clearly compelled by statutory text. This Court should grant certiorari.

ARGUMENT

I. The Government Agrees That The Third Circuit's Reasoning Is Wrong (Twice Over), And The Government's Alternative Theory in Support of the Third Circuit's Result Has Been Rejected By Every Court To Consider It.

The government agrees with petitioners that the Third Circuit panel majority's analysis is untenable. As the government explains, the panel majority's "holding that the absolute-priority rule applies" simply "disregards the express limits" that Congress enacted in the text of 11 U.S.C. §1129(b). U.S.Br.16-17. By holding that "the absolute-priority rule codified in Section 1129(b) applies to all creditors, not just the dissenting impaired creditors who can invoke that provision directly," the panel majority's approach "stretch[es] the text of Section 1129(b) past its limits." U.S.Br.17. The government accordingly "disagrees with the reasoning adopted by the court of appeals." U.S.Br.2; *see also* U.S.Br.16-17.

So far, so good. But instead of reaching the obvious conclusion—that this Court should grant review and reverse the erroneous precedent—the government argues that this Court should leave the erroneous precedent in place because (the government says) the panel majority erred on a different, logically anterior issue and inadvertently stumbled into the correct result in mandating the payment of unmatured interest obligations expressly disallowed by the Code. U.S.Br.2, 10.

That two-wrongs-make-for-a-right-result view is an astonishing position for the government to take. Even setting aside the dubious wisdom of leaving an admittedly incorrect court of appeals decision as binding precedent just because a similar result could conceivably be justified on other grounds (albeit other grounds squarely foreclosed by circuit precedent and with a different resulting interest rate), the government's alternative theory that disallowance *by the Code* constitutes impairment *by the plan* is both plainly incorrect and an outlying view with serious implications for disputes going well beyond unmatured interest. Indeed, as the government concedes, "various courts of appeals"—by which it means every court of appeals to address the issue, including the Third Circuit in the decision below and in its prior decision in *In re PPI Enters. (U.S.), Inc.*, 324 F.3d 197 (3d Cir. 2003)—"have rejected" the government's theory. U.S.Br.14.

And it is not just courts of appeals that have uniformly rejected the government's view. Literally *every single court to address the question* has rejected the government's theory (except for one bankruptcy court that the Fifth Circuit quickly and unanimously reversed), producing a "monolithic mountain of authority" confirming that the government is wrong. *Ultra*, 943 F.3d at 760; *see, e.g.*, *In re LATAM Airlines Grp. S.A.*, 55 F.4th 377, 384-85 (2d Cir. 2022) ("We therefore join the Third, Fifth, and Ninth Circuits and hold that a claim is impaired under Section 1124(1) only when the plan of reorganization, rather than the Code, alters the creditor's legal, equitable, or contractual rights."); *In re PG&E Corp.*, 46 F.4th 1047, 1063 n.11 (9th Cir. 2022) ("As our sibling circuits have held, an alteration of pre-bankruptcy rights that occurs by operation of the Code does not result in impairment."); *PPI*, 324 F.3d at 202; *see also* 7 Collier on Bankruptcy ¶1124.03[6] (16th ed. 2018) ("Alteration of Rights by the Code Is Not Impairment under Section 1124(1)."). Even the divided panel below was unanimous in rejecting the theory that the government now adopts here. *See* App.30 n.20 ("Impairment is the alteration of a creditor's rights by a plan, not alterations to those rights as directed by the Bankruptcy Code."); App.45 (finding respondents unimpaired because "it is the Code that alters [their] right, not the Plan").

That uniform rejection of the government's theory is unsurprising, as it cannot be squared with the statutory text. Under §1124(1), a claim is unimpaired as long as "*the plan* … leaves unaltered" the claimant's rights, regardless of whether *the Code* alters those rights. 11 U.S.C. §1124(1) (emphasis added). A plan that simply "incorporates the Code's disallowance provisions," and thereby affords creditors everything they are entitled to receive under the Code, does not itself impair those creditors' rights. *Ultra*, 943 F.3d at 762; *see, e.g.*, *PPI*, 324 F.3d at 204 (recognizing that "a creditor's claim outside of bankruptcy is not the relevant barometer for impairment," and courts "must examine whether the plan itself is a source of limitation on [the creditor's] rights" rather than the

Code"); Reply.4. That result makes sense, as the whole point of §1124 is to determine which classes of creditors get to vote on the plan. If the plan is what is impairing a class of creditors, they get a vote on whether to approve the plan. But there is no basis for calling a plebiscite to see whether creditors like the way Congress treated them in the Code. That approach would simply allow creditors who are already receiving everything that Congress has allowed under the Code to insist on even more, by refusing to vote for confirmation unless the debtor pays them more than Congress deemed allowable. Put simply, the courts are unanimous because only a focus on plan impairment, not Code impairment, makes sense and comports with the text.

The government insists that "Section 1124(1)'s definition of impairment is not limited to the alteration of *allowed* claims." U.S.Br.11. But that ignores the salient point: When the Code disallows a claim, it is *the Code*, not the plan, that is altering the rights associated with that claim. The government invokes legislative history, attempting to divine some significance from Congress' repeal of former §1124(3) and an accompanying House Report. U.S.Br.12-13. Of course, "legislative history is not the law." *Epic Sys. Corp. v. Lewis*, 584 U.S. 497, 523 (2018). Regardless, the legislative history shows only that Congress wanted unimpaired claims to receive *some* post-petition interest in solvent-debtor cases—namely, post-petition interest at the federal judgment rate, which is the rate the Code prescribes in solvent-debtor Chapter 7 cases and precisely what respondents received under the plan here. *See* 11 U.S.C. §726(a)(5); Pet.6-7. Moreover, this legislative history is not some new discovery. It has been the last redoubt of losing advocates and thoroughly discussed in the decisions uniformly rejecting the government's view that Code impairment, rather than plan impairment, is what counts. *See, e.g.*, *Ultra*, 943 F.3d at 764; *PPI*, 324 F.3d at 205-07.

The government notes that the Code does not "preclude[] confirmation of a plan that pays disallowed claims." U.S.Br.14-15. That is, the Code *permits* Chapter 11 debtors to pay their creditors more than the baseline amount that the Code requires. U.S.Br.15. That is true, but irrelevant. It does not somehow mean that a creditor who receives everything to which the Code entitles it is somehow impaired, let alone impaired by the plan.

The government asserts that it is "inaccurate to say that the Code itself alters the legal rights underlying a claim," and that in reality those rights "are altered only through the confirmation of a proposed reorganization plan." U.S.Br.15-16. But as the Fifth Circuit has explained, that argument simply "begs the critical question" of whether the claim is being limited by the will of Congress reflected in the Code or by the plan that pays everything the Code allows. *Ultra*, 943 F.3d at 765. As the Fifth Circuit observed, "every reported decision" agrees that "[w]here a plan refuses to pay funds disallowed by the Code, the Code—not the plan—is doing the impairing." *Id.*

To be clear, none of the government's arguments on this score is new, and none is correct. Respondents raised the same basic arguments, and the divided court below was unified in rejecting them. As a result, these arguments remain open to the government and respondents if the Court grants certiorari on the question presented. Dozens of courts—from specialized bankruptcy courts to generalist appellate courts—have considered these arguments and found them wanting. If that monolithic mountain of authority is correct, then there is no reason for this Court not to grant certiorari, address the issue that has divided the circuits, and reverse the Third Circuit's absolute-priority reasoning that the government itself agrees is dead wrong.

But if the government's theory is somehow right, it only strengthens the case for granting certiorari. If the government is correct, then everyone else is wrong. Not only the Third Circuit below but also the Second, Fifth, and Ninth Circuits should not have even addressed absolute-priority rules or solvent-debtor exceptions, and all those circuits and every other court to address the question are all analyzing the impairment question incorrectly. That error would not be limited to questions of unmatured interest, but would extend to every kind of claim disallowed by the Code. If all those courts are wrong on a critical and recurring question, the case for plenary review is overwhelming.

In short, there are only two possibilities: Either the government's alternative theory is wrong, in which case the result below is plainly wrong and there is no valid reason to leave in place the Third Circuit's absolute-priority reasoning, which even the government agrees is wrong. Or, if (contrary to all appearances) the government is right, this Court should grant certiorari and correct the misunderstanding of every other court that has considered the question. In either event, this Court should grant review.[1]

II. The Decision Below Contributes To The Growing Confusion In The Lower Courts.

The government has no persuasive answer to the growing confusion in the lower courts on this issue (which is unsurprising, because the government's amicus brief only adds to the confusion). The government does not dispute that the Third Circuit's decision conflicts with decisions from lower courts across the country. Pet.24-25; *see* U.S.Br.20 n.2. And while the government attempts to deny a circuit split, it cannot avoid the obvious conflicts in the relevant decisions. In fact, the government acknowledges that the panel majority expressly split with the Second Circuit on the absolute-priority question and pointedly departed from the reasoning of the Fifth and Ninth Circuits, and no one can deny that the three judges who focused on the text of the Code, rather than pre-Code judicial innovations, all ended up in dissent.

The panel majority itself recognized that "[t]he Second Circuit disagreed in *LATAM*" with the panel

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[1] In a striking display of chutzpah, the government notes that petitioners "point to no conflict" on whether disallowance by the Code constitutes impairment by the plan. U.S.Br.21. That is because every single court to address the issue *agrees that the government is wrong*. *See supra* pp.3-4. And the government is also wrong to suggest that resolving its alternative theory in this case would have no "meaningful practical effect," U.S.Br.21; given that the government agrees the Third Circuit's actual reasoning is mistaken, holding that the government's alternative theory is also wrong would require reversal.

majority's holding that the Code "incorporates the common law absolute priority rule" and "requires creditors' obligations be paid in full before owners … take anything at all." App.32, 34 n.22, 35; *see LATAM*, 55 F.4th at 387-89 (rejecting the argument that a "solvent-debtor exception aris[ing] from the absolute priority rule" requires paying post-petition interest at contract rates "whenever a plan will return value to equity"). The government admits that the panel majority "considered [*LATAM*] to be in tension with its view." U.S.Br.19. And the conflict runs deeper still. The Second Circuit in *LATAM* correctly recognized that the panel majority's absolute-priority theory was at war with both the text of §1129(b) and this Court's decision in *LaSalle*. *See LATAM*, 55 F.4th at 388. The Third Circuit panel majority, by contrast, not only ignored the conflict with *LaSalle* but claimed that its misguided result was compelled by *Jevic*. App.29-32. No one, including the government, defends the latter the-Supreme-Court-made-me-do-it theory, which underscores the need for this Court's intervention.

The government denies any conflict between the decision below and the Ninth Circuit's decision in *In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002), claiming that *Cardelucci* merely held that "interest at the legal rate" in 11 U.S.C. §726(a)(5) refers to the federal judgment rate, and has "no bearing on" what amounts must be paid to unimpaired creditors. U.S.Br.20. But *Cardelucci* squarely held that an unsecured creditor in a solvent-debtor Chapter 11 case was entitled to recover post-petition interest at the federal judgment rate, not the state statutory rate that would have applied outside of bankruptcy. *Cardelucci*, 285 F.3d at 1234-36. That cannot be reconciled with the panel majority's contrary holding that creditors in solvent-debtor cases are entitled to "the equitable rate of post-petition interest, whatever that may be" rather than the federal judgment rate. App.35. Nor can it be reconciled with the government's Code-impairment-is-plan-impairment theory, which would always entitle a creditor of a solvent debtor to the rate of interest specified in the contract.

The government cannot reconcile the decision below with the Fifth and Ninth Circuits' divided decisions in *Ultra* and *PG&E* either. *See* Pet.29-32; Reply.9-11. The government acknowledges that unlike the decision below, "the Fifth and Ninth Circuits did not rely on Section 1129(b)," U.S.Br.18, which is why even Wells Fargo acknowledges the "inconsistency" between the panel majority's reasoning and the reasoning of *Ultra* and *PG&E*, BIO.17. Saying that those opinions are basically the same because they all "grounded their analysis in the same pre-Code practice," U.S.Br.18, is simply not correct. And while it might be fair to say that all three decisions avoided the clear answer provided by the Code by invoking varying pre-Code judicial doctrines, that is hardly a strike against certiorari.

The government acknowledges that the decision below and the Ninth Circuit have "authorized imposition of post-petition interest at the equitable rate" (whatever that may be) rather than the contractual rate, while the Fifth Circuit "has not expressly adopted that position." U.S.Br.18. The government's speculation that the Fifth Circuit might eventually come around to the Third and Ninth Circuits' view on that question hardly eliminates the ongoing confusion now. *Contra* U.S.Br.18. Moreover, if any court ever adopts the government's position on plan-versus-Code-impairment, it would require application of the contractual rate of interest—not an equitable rate—and deepen the split. Simply put, the confusion is not going away on its own, and the government's disagreement with a monolithic mountain of authority only adds to the problem.

III. The Question Presented Is Exceptionally Important.

The government thinks that the Third Circuit is wrong twice over—wrong on the logically anterior Code-versus-plan-impairment question, where the Third Circuit agrees with every court in the land, and wrong on the absolute-priority question, where the Third Circuit has charted its own path. The government does not claim that those errors are unimportant or that leaving them embedded in circuit precedent makes any sense. Nor does the government doubt the substantial practical importance (typically, as here, running to hundreds of millions of dollars) of the question presented in the cases where it arises. *See* Pet.33-36. Instead, the government argues only that the question presented "arises infrequently." U.S.Br.21. But while solvent-debtor bankruptcies are rarer than insolvent-debtor bankruptcies, they are hardly rare in absolute terms—which is why pre-Code courts developed the solvent-debtor doctrine and why four federal courts of appeals in just the past four years have found themselves wrestling with the temptation to apply that pre-Code doctrine in lieu of the Code itself. *See* App.6-7; *LATAM*, 55 F.4th at 384-89; *In re Ultra Petroleum Corp.*, 51 F.4th 138, 142 (5th

Cir. 2022); *PG&E*, 46 F.4th at 1057-63. And those circuit cases are just the tip of an iceberg. As with most bankruptcy issues, most solvent-debtor cases never reach the courts of appeals, but still befuddle the bankruptcy and district courts. *See, e.g.*, Pet.24-25 (collecting cases).

All that explains why even Wells Fargo concedes that this issue has arisen repeatedly in the lower courts (and "has determined the distribution of large sums of money"). BIO.21. While every bankruptcy "involve[s] idiosyncratic factual circumstances," U.S.Br.21, the question presented here is a recurring issue that will continue to arise until this Court finally intervenes and provides much-needed clarity. This Court should not permit the courts of appeals to continue to answer that question incorrectly, and should not allow the divided panel decision below—the reasoning of which the government views as doubly flawed—to remain binding precedent. Instead, the Court should grant certiorari and reverse.

CONCLUSION

This Court should grant certiorari.

Respectfully submitted,

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