SUPREME COURT OF THE UNITED STATES

No. 97–1418

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, PETITIONER *v.* 203 NORTH LASALLE STREET PARTNERSHIP

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

[May 3, 1999]

JUSTICE STEVENS, dissenting.

Prior to the enactment of the Bankruptcy Reform Act of 1978, this Court unequivocally stated that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor if their participation is based on a contribution in money, or in money's worth, reasonably equivalent in view of all the circumstances to their participation.[1] As we have on two

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[1] As Justice Douglas explained in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106 (1939): "It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor. This Court, as we have seen, indicated as much in *Northern Pacific Ry. Co.* v. *Boyd*[, 228 U. S. 482 (1913),] and *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*[, 271 U. S. 445 (1926)]. Especially in the latter case did this Court stress the necessity, at times, of seeking new money 'essential to the success of the undertaking' from the old stockholders. Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made. . . .

"In view of these considerations we believe that to accord 'the creditor his full right of priority against the corporate assets' where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of prior occasions,[2] we granted certiorari in this case to decide whether §1129(b)(2)(B)(ii) of the 1978 Act preserved or repealed this "new value" component of the absolute priority rule. I believe the Court should now definitively resolve the question and state that a holder of a junior claim or interest does not receive property "on account of" such a claim when its participation in the plan is based on adequate new value.

The Court today wisely rejects the Government's "starchy" position that an old equity holder can never receive an interest in a reorganized venture as a result of a cramdown unless the creditors are first paid in full. *Ante*, at 15–16.[3] Nevertheless, I find the Court's objections to the plan before us unsupported by either the text of 11 U. S. C. §1129(b)(2)(B)(ii) or the record in this case. I would, therefore, affirm the judgment of the Court of Appeals.

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all the circumstances to the participation of the stockholder." *Id.*, at 121–122 (footnote omitted).

[2] See *Norwest Bank Worthington* v. *Ahlers,* 485 U. S. 197, 203, n. 3 (1988); *U. S. Bancorp Mortgage Co.* v. *Bonner Mall Partnership,* 513 U. S. 18 (1994).

[3] As I noted earlier, see n. 1, *supra*, Justice Douglas made this proposition clear in *Case* v. *Los Angeles, supra*. Justice Douglas was a preeminent bankruptcy scholar, well known for his views on the dangers posed by management-controlled corporate reorganizations. Both his work on the Protective Committee Study for the Securities and Exchange Commission and on Chapter X of the Bankruptcy Act sought to "restore the integrity of the reorganization process" which "too often [was] masterminded from behind the scenes by reorganization managers allied with the corporation's management or its bankers." Jennings, Mr. Justice Douglas: His Influence on Corporate and Securities Regulation, 73 Yale L. J. 920, 935–937 (1964). To this end, Douglas placed special emphasis on the protection of creditors' rights in reorganizations. Hopkirk, William O. Douglas– His Work in Policing Bankruptcy Proceedings, 18 Vand. L. Rev. 663, 685 (1965). I find it implausible that Congress, in enacting the Bankruptcy Code, intended to be even more strict than Justice Douglas in limiting the ability of debtors to participate in reorganizations.

I

Section 1129 of Chapter 11 sets forth in detail the substantive requirements that a reorganization plan must satisfy in order to qualify for confirmation.[4] In the case of dissenting creditor classes, a plan must conform to the dictates of §1129(b). With only one exception, the requirements of §§1129(a) and 1129(b) are identical for plans submitted by stockholders or junior creditors and plans submitted by other parties. That exception is the requirement in §1129(b)(2)(B)(ii) that no holder of a junior claim or interest may receive or retain any property "on account of such junior claim or interest."

When read in the light of Justice Douglas' opinion in *Case* v. *Los Angeles Lumber Products Co.,* 308 U. S. 106 (1939), the meaning of this provision is perfectly clear. Whenever a junior claimant receives or retains an interest for a bargain price, it does so "on account of" its prior claim. On the other hand, if the new capital that it invests has an equivalent or greater value than its interest in the reorganized venture, it should be equally clear that its participation is based on the fair price being paid and that it is not "on account of" its old claim or equity.

Of course, the fact that the proponents of a plan offer to pay a fair price for the interest they seek to acquire or retain does not necessarily mean that the bankruptcy judge should approve their plan. Any proposed cramdown must satisfy all of the requirements of §1129 including, most notably, the requirement that the plan be "fair and equitable" to all creditors whose claims are impaired. See §1129(b)(1). Moreover, even if the old stockholders propose to buy the

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[4] "Confirmation of a plan of reorganization is the statutory goal of every chapter 11 case. Section 1129 provides the requirements for such confirmation, containing Congress' minimum requirements for allowing an entity to discharge its unpaid debts and continue its operations." 7 Collier on Bankruptcy ¶ 1129.01 (rev. 15th ed. 1998).

debtor for a fair price, presumably their plan should not be approved if a third party, perhaps motivated by unique tax or competitive considerations, is willing to pay an even higher price. Cf. §1129(c).

In every reorganization case, serious questions concerning the value of the debtor's assets must be resolved.[5] Nevertheless, for the purpose of answering the legal question presented by the parties to this case, I believe that we should assume that all valuation questions have been correctly answered. If, for example, there had been a widely advertised auction in which numerous bidders participated, and if the plan proposed by respondents had been more favorable by a wide margin than any competing proposal, would §1129(b)(2)(B)(ii) require rejection of their plan simply because it provides that they shall retain 100% of the equity?

Petitioner and the Government would reply "yes" because they think §1129(b)(2)(B)(ii) imposes an absolute ban on participation by junior claimants without the consent of all senior creditors. The Court correctly rejects this extreme position because it would make the words "on account of" superfluous, and because there is no plausible reason why Congress would have desired such a categorical exclusion, given that in some cases old equity may be the most likely source of new capital. See *ante,* at 17. Indeed, the dissenting judge in the Court of Appeals thought "such a result would border on the absurd."[6]

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[5] See Warren, A Theory of Absolute Priority, 1991 Ann. Survey Am. L. 9, 13 ("In practice, no problem in bankruptcy is more vexing than the problem of valuation").

[6] Judge Kanne wrote in dissent: "Perhaps the majority's reasoning is driven by the fear that a 'but for' interpretation would prevent old equity from ever participating in a reorganized entity–something Congress could never have intended. Indeed, such a result would border on the absurd, but a simpler, 'but for' causation requirement would not preclude junior interests from participating in a reorganized

Thus, neither the dissenting judge in the Court of Appeals nor the Court appears to be in doubt about the proper answer to my hypothetical question. Instead, the decision is apparently driven by doubts concerning the procedures followed by the Bankruptcy Judge in making his value determinations, implicitly suggesting that the statute should be construed to require some form of competitive bidding in cases like this.[7] See *ante*, at 20–22.

Perhaps such a procedural requirement would be a wise addition to the statute, but it is surely not contained in the present text of §1129(b)(2)(B)(ii). Indeed, that subsection is not a procedural provision at all. Section 1129 defines the substantive elements that must be met to render plans eligible for confirmation by the bankruptcy judge after all required statutory procedures have been completed. Cf. §1121 (Who may file a plan); §1122 (Classification of claims or interests); §1125 (Postpetition disclosure and solicitation); §1126 (Acceptance of plan); §1127 (Modifica-

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entity. If prior equity holders earn their shares in an open auction, for example, their received interests would not be 'on account of' their junior interests but 'on account of' their capital contributions." *In re 203 N. LaSalle Street Partnership*, 126 F. 3d 955, 972 (CA7 1997).

It would seem logical for adherents of this view also to find participation by junior interests in the new entity not "on account of" their prior interest, if it were stipulated that old equity's capital contributions exceeded the amount attainable in an auction, or if findings to that effect were not challenged.

[7] This doubt is unwarranted in this case. The bank does not challenge the Bankruptcy Court's finding that the 15 floors of office space had a market value of $55.8 million. The bank's original expert testimony on the value of the property differed from the Bankruptcy Judge's finding by only 2.8%. *In re 203 North LaSalle Street Partnership*, 190 B. R. 567, 573–576 (Bkrtcy. Ct. ND Ill. 1995). Therefore, although the bank argues that the policy implications of the "new value debate" revolve around judicial determinations of the valuation of the relevant collateral, Brief for Petitioner 5, n. 2, this concern was neither squarely presented in this case nor preserved for our review.

tion of plan). Because, as I discuss below, petitioner does not now challenge either the procedures followed by the Bankruptcy Judge or any of his value determinations, neither the record nor the text of §1129(b)(2)(B)(ii) provides any support for the Court's disposition of this case.

II

As I understand the Court's opinion, it relies on two reasons for refusing to approve the plan at this stage of the proceedings: one based on the plan itself and the other on the confirmation procedures followed before the plan was adopted. In the Court's view, the fatal flaw in the plan proposed by respondent was that it vested complete ownership in the former partners immediately upon confirmation, *ante*, at 18, and the defect in the process was that no other party had an opportunity to propose a competing plan.

These requirements are neither explicitly nor implicitly dictated by the text of the statute. As for the first objection, if we assume that the partners paid a fair price for what the Court characterizes as their "exclusive opportunity," I do not understand why the retention of a 100% interest in assets is any more "on account of" their prior position than retaining a lesser percentage might have been. Surely there is no legal significance to the fact that immediately after the confirmation of the plan "the partners were in the same position that they would have enjoyed had they exercised an exclusive option under the plan to buy the equity in the reorganized entity, or contracted to purchase it from a seller who had first agreed to deal with no one else." *Ante*, at 19.

As to the second objection, petitioner does not challenge the Bankruptcy Judge's valuation of the property or any of his other findings under §1129 (other than the plan's compliance with §1129(b)(2)(B)(ii)). Since there is no remaining question as to value, both the former partners (and the creditors, for that matter) are in the same position that they would have enjoyed if the Bankruptcy Court had held an auction in which this plan had been determined to be the best available. That the court did not hold such an auction should not doom this plan, because no such auction was requested by any of the parties, and the statute does not require that an auction be held. As with all the provisions of §1129, the question of compliance with §1129(b)(2)(B)(ii) turns on the substantive content of the plan, not on speculation about the procedures that might have preceded its confirmation.

In this case, the partners had the exclusive right to propose a reorganization plan during the first 120 days after filing for bankruptcy. See §1121(b). No one contends that that exclusive right is a form of property that is retained by the debtor "on account of" its prior status.[8] The partners did indeed propose a plan which provided for an infusion of $6.125 million in new capital in exchange for ownership of the reorganized debtor. Since the tax value of the partnership depended on their exclusive participation, it is unsurprising that the partners' plan did not propose that unidentified outsiders should also be able to own an unspecified portion of the reorganized partnership. It seems both practically and economically puzzling to assume that Congress would have expected old equity to provide for the participation of unknown third parties, who would have interests different (and perhaps incompatible) with the partners', in order to comply with §1129(b)(2)(B)(ii).[9]

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[8] Indeed, as the Court acknowledges, *ante*, at 19, it is not "property" within the meaning of the Act.

[9] It goes without saying that Congress could not have expected the partners' plan to include a provision that would allow for the Bankruptcy Judge to entertain competing plans, since that is a discretionary decision exclusively within the province of the court. See §1121(d).

Nevertheless, even after proposing their plan, the partners had no vested right to purchase an equity interest in the postreorganization enterprise until the Bankruptcy Judge confirmed the plan. They also had no assurance that the court would refuse to truncate the exclusivity period and allow other interested parties to file competing plans. As it turned out, the Bankruptcy Judge did not allow respondent to file its proposed plan, but the bank did not appeal that issue, and the question is not before us.[10]

The moment the judge did confirm the partners' plan, the old equity holders were required by law to implement the terms of the plan.[11] It was then, and only then, that

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[10] Apparently, the bank's plan called for liquidation of the property. In order to flesh out all facts bearing on value, perhaps the Bankruptcy Judge should have terminated the exclusivity period and allowed the bank to file its plan. That the bank's plan called for liquidation of the property in a single-asset context does not necessarily contravene the purposes of Chapter 11. See, *e.g., In re River Village Associates*, 181 B. R. 795, 805 (ED Pa. 1995).

[11] Section 1141(a) states: "Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan."

See 8 Collier on Bankruptcy ¶ 1141.02. ("Section 1141(a) of the Code provides that a plan is binding upon all parties once it is confirmed. Under this provision, subject to compliance with the requirements of due process under the Fifth Amendment, a confirmed plan is binding upon every entity that holds a claim or interest . . ."); see also §1142(a).

In this case, the plan provided: "The general partners and limited partners of the Reorganized Debtor shall contribute or cause to be contributed $6.125 million of new capital (the "New Capital") to the Reorganized Debtor as follows: $3.0 million in cash ("Initial Capital") on the first business banking day after the Effective Date, and $625,000 on each of the next five anniversaries of the Effective Date." App. 38–39. The "Effective Date" of the plan was defined as "[t]he first business what the Court characterizes as the critical "exclusive opportunity" came into existence. What the Court refuses to recognize, however, is that this "exclusive opportunity" is the function of the procedural features of this case: the statutory exclusivity period, the Bankruptcy Judge's refusal to allow the bank to file a competing plan, and the inescapable fact that the judge could confirm only one plan.

The Court's repeated references to the partners' "opportunity," see *ante,* at 18, 19, 20, 21, is potentially misleading because it ignores the fact that a plan is binding upon all parties once it is confirmed. One can, of course, refer to contractual rights and duties as "opportunities," but they are not separate property interests comparable to an option which gives its holder a legal right either to enter into a contract or not to do so. They are simply a part of the bundle of contractual terms that have legal significance when a plan is confirmed.

When the court approved the plan, it accepted an offer by old equity. If the value of the debtor's assets has been accurately determined, the fairness of such an offer should be judged by the same standard as offers made by newcomers. Of course, its offer should not receive more favorable consideration "on account of" their prior ownership. But if the debtor's plan would be entitled to approval if it had been submitted by a third party, it should not be disqualified simply because it did not include a unique provision that would not be required in an offer made by any other party, including the creditors.

Since the Court of Appeals correctly interpreted §1129(b)(2)(B)(ii), its judgment should be affirmed.

Accordingly, I respectfully dissent.

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day after the Confirmation Order is entered on the docket sheet maintained for the Case." *Id.*, at 24.