No. 99-409

IN THE SUPREME COURT OF THE UNITED STATES

HARTFORD UNDERWRITERS INSURANCE COMPANY,
Petitioners,

v.

MAGNA BANK, N.A.,
Respondent.

BRIEF OF *AMICUS CURIAE*
COMMERCIAL FINANCE ASSOCIATION
IN SUPPORT OF RESPONDENT

Filed January 26, 2000

This is a replacement cover page for the above referenced brief filed at the U.S. Supreme Court. Original cover could not be legibly photocopied

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The Commercial Finance Association ("CFA") respectfully submits this brief as *amicus curiae* in support of the respondent.[1]

STATEMENT OF INTEREST

CFA is the national trade association for financial institutions that provide asset-based commercial financing and factoring services to business borrowers. Among the nearly 300 members of CFA are substantially all of the major money center and important regional banks and other large and small commercial lenders. CFA members provide financing to businesses on an international, national, regional and local scale. Most of the borrowers served by CFA members depend on secured financing to operate and grow. This financing is generally secured by various forms of personal and real property collateral, including accounts receivable, inventory, equipment, and other property owned by the

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[1] Pursuant to Sup. Ct. R. 37.6, *amicus curiae* states that no counsel for any party to this dispute authored this brief in whole or in part, and that no person or entity, other than *amicus curiae* and its member entities, as part of their regular contributions and support of the CFA, made a monetary contribution to the preparation or submission of this brief. Capital Factors, Inc., a wholly owned subsidiary of respondent Union Planters Bank, N.A. (successor to Magna Bank, N.A.), is a member of *amicus curiae* CFA. Both petitioner and respondent have consented to the filing of this brief, and a letter evidencing such consent has been filed with the Office of the Clerk of this Court. *See* Sup. Ct. R. 37.3.

borrowers. Secured financing provided by CFA members comprises a substantial portion of the national credit market.

CFA has a substantial interest in this case because the position advocated by petitioner would subject its members, as secured lenders, to surcharge claims in bankruptcy from any entity which dealt with a bankruptcy estate and remained unpaid. Such a rule would constitute a dramatic expansion of the surcharge rights which such entities would have against secured lenders outside of bankruptcy, and would make secured lenders potential guarantors of the unpaid administrative expenses of a bankruptcy estate. For the reasons set forth below, CFA believes that such a rule is contrary to the language of § 506(c) of the Bankruptcy Code[2] as well as the structure and logic of the Bankruptcy Code, and would be an unjustified invasion of lien rights which, as a general matter, are supposed to pass through bankruptcy unaffected.

SUMMARY OF ARGUMENT

Petitioner argues that § 506(c) creates a private right of action which permits creditors that deal with a bankruptcy estate to surcharge a secured creditor's collateral. The private right of action which petitioner seeks, however, is far

[2] Except as otherwise noted, all statutory references herein are to the Bankruptcy Code, 11 U.S.C. § 101 *et seq.*

broader than the rights it otherwise would have against respondent secured creditor under applicable state law. There is no indication, and no plausible reason to believe, that in crafting a provision which grants surcharge rights solely to "the trustee," Congress intended to both federalize and liberalize the applicable state law and to subject secured creditors to claims which they would not have faced outside of bankruptcy.

In addition, petitioner's reading of the statute is inconsistent with the Bankruptcy Code's overall theme and structure, which defines the rights and remedies of parties with respect to their relationship with the bankruptcy estate, and not with relationship to one another. It would also violate the general premise of the Bankruptcy Code that, except where explicitly provided, secured creditors' liens are to pass through bankruptcy unaffected, and would engraft a new judicially-created priority of distribution onto the precisely detailed schedule of priorities now set forth in the statute. Finally, by exposing secured creditors to the risk of having to pay the unpaid administrative expenses of a bankruptcy estate, petitioner's construction will make it more likely that secured creditors will seek early relief from the stay, thereby reducing the likelihood of reorganizations and of recoveries for prepetition creditors.

ARGUMENT

I. PETITIONER'S POSITION WOULD CREATE A SUBSTANTIVE BANKRUPTCY RIGHT OF ACTION TO SURCHARGE COLLATERAL FAR BROADER THAN APPLICABLE NON-BANKRUPTCY LAW

Outside of bankruptcy, there is a venerable body of law which determines when someone is entitled to payment for conferring a benefit on another with whom he otherwise does not have a contractual relationship. This is the law of unjust enrichment or restitution, sometimes denominated as *quantum meruit*.

An entity seeking to collect on a theory of unjust enrichment or restitution must satisfy certain criteria and overcome various defenses. *See generally* RESTATEMENT OF RESTITUTION (1937). Most important for present purposes is the general rule that a party performing under a contract with one entity cannot collect on a restitution theory from a different entity which may have benefited from the performance in question. RESTATEMENT OF RESTITUTION § 110 (1937).[3] The burden on the party seeking restitution is even greater when it seeks recovery from a secured creditor, because the restitution claim undermines the clear priority rules sought to be established by Article 9 of the Uniform Commercial Code. *See generally* 1 Barkley Clark, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE ¶ 3.14[3], at 3-212 to 3-215 (1999) ("Allowing unsecured suppliers to prime secured lenders is upside down.").[4]

Certain state courts recognize an exception to the secured creditors' priority, and permit restitution from a

[3] In the words of the RESTATEMENT:

> A person who has conferred a benefit upon another as the performance of a contract with a third person is not entitled to restitution from the other merely because of the failure of performance by the third person.

[4] Notably, apart from any possible applicability of unjust enrichment law, the respective rights of petitioner and respondent would have been determined according to standard lien priority rules, under which respondent secured creditor would prevail. For example, a seller of goods to an insolvent entity, which is entitled to reclamation under section 2-702 of the Uniform Commercial Code, ordinarily has its rights subordinated to those of a secured creditor with a security interest in those goods – even though the secured creditor obviously benefited when the goods became part of its collateral. 2 Barkley Clark, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE ¶ 10.06[4], at 10-118 (1999). Thus, the fact that the rights of a secured creditor are superior to those of a seller whose goods directly augmented the amount of the secured creditor's collateral is indicative of the limited extent to which the rights of secured creditors can be subordinated to those of unsecured creditors outside of bankruptcy.

secured creditor which initiated or encouraged the performance that gave rise to its direct benefit. *Ninth Dist. Prod. Credit Ass'n v. Ed Duggan, Inc.*, 821 P.2d 788, 794-98, 800 (Colo. 1991) (*en banc*). But even this exception is not uniformly accepted; there is "an apparent split of authority" among the various state courts, which discrepancy arguably "can be reconciled, although the courts' analyses are concededly in tension." *Id.* at 795. *See also Knox v. Phoenix Leasing Inc.*, 35 Cal. Rptr. 2d 141, 144-45 (Cal. Ct. App. 1994) (describing courts permitting restitution from secured creditors as contrary to the "majority position" but suggesting that the disagreement "is not nearly so profound as appears at first glance.").

Notably, the Missouri law on the subject, which otherwise would have been applied here, is even more restrictive. Under Missouri law, an unjust enrichment action could not overcome an Article 9 lien priority absent a showing of the secured creditor's fraud. *Commerce Bank, N.A. v. Tifton Aluminum Co.*, 217 B.R. 798, 802 (W.D. Mo. 1997). *Accord, Peerless Packing Co. v. Malone & Hyde, Inc.*, 376 S.E.2d 161, 164 & n.4 (W. Va. 1988) (recognizing only a fraud exception to secured creditors' priority).

In this case, petitioner, an insurance company, provided workers' compensation insurance to the debtor Hen House International, Inc., substantially all of whose assets were pledged to respondent Magna Bank. But for the intervention of bankruptcy, it is absolutely clear that respondent would not have been liable to petitioner for the unpaid insurance premiums. Petitioner's contractual relationship was exclusively with the debtor, and under the rule in RESTATEMENT § 110 it could not look to respondent or any other third party for compensation when the debtor did not pay. Moreover, among other things, there was no evidence

below that respondent initiated or encouraged petitioner to provide insurance, as required under *Duggan*, *supra*, and there was certainly not a hint of fraud by the secured creditor, as required by the applicable Missouri law.

Nevertheless, petitioner argues that once bankruptcy intervened, its substantive entitlements changed. It maintains that § 506(c) entitles it to recover all of "the reasonable, necessary costs and expenses of preserving, or disposing of," respondent's collateral, "to the extent of any benefit" which respondent received. This standard for recovery omits many of the applicable state law hurdles to restitution from third parties. Petitioner nowhere explains why the intercession of bankruptcy should be deemed to create a new private right of action which is more liberal than the applicable state law restitution rule.

The most astounding part of petitioner's contention is that it is based on a statute which, by its terms, confers the right to surcharge collateral only on the trustee (a term which includes those who, like the debtor-in-possession under § 1107(a), exercise the rights of a trustee). Section 506(c) is explicit – "The *trustee* may recover from property securing an allowed secured claim . . ." (emphasis supplied). Especially in bankruptcy cases, this Court has adhered to the common-sense principle that statutes should be interpreted in accordance with their plain meaning. *E.g.*, *Rake v. Wade*, 508 U.S. 464, 471 (1993); *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989). Where a statute gives a surcharge right to trustees, it makes little sense to interpret it as a mandate to expand the state law rights of non-trustee entities, particularly where the state law on the subject is not uniform and even the most liberal state law cases are far more restrictive than § 506(c).

II. ESTABLISHING A PRIVATE RIGHT OF SURCHARGE IS CONTRARY TO THE SCHEME AND STRUCTURE OF THE BANKRUPTCY CODE

Even apart from its plain language, § 506(c) is not susceptible to interpretation as establishing a private right of action for surcharge because such an interpretation would be contrary to the structure and scheme of the Bankruptcy Code. Throughout, the Bankruptcy Code prescribes the rights of parties only with relation to the bankruptcy estate,[5] and eschews any attempt to declare the rights of nondebtor parties as between themselves. In fact, in the two instances in which the Code addresses the rights of parties *inter sese*, it is

[5] The commencement of a bankruptcy case creates a bankruptcy estate. § 541. Entities have claims against or interests in the estate, §§ 501-03; they are required to surrender any estate property to the estate, § 542; and they are susceptible to avoidance actions and other claims by the estate, §§ 544-51. At the completion of the case, parties receive their distributions from the estate, whether under the liquidation provisions of chapter 7 or the reorganization provisions of chapter 11 and 13, or under special provisions related to municipalities and railroads. And when the Bankruptcy Code recognizes that the rights of some parties are superior to those of others, it does so only in terms of the ranking of those rights vis-à-vis the estate. See, for example, §§ 502(b) (disallowance of certain claims against the estate); 503 (administrative claims); 507 (priority claims); 510(b) (subordination of securities claims); 726 (priority of distributions in chapter 7 liquidations); 1129(b)(2) (priority of distributions in chapter 11 reorganizations).

only to declare that those rights are preserved as they were apart from the Bankruptcy Code. One of these instances is § 510(a), which declares that subordination agreements remain enforceable to the same extent as under applicable nonbankruptcy law. The other instance is § 524(e), which generally provides that a bankruptcy discharge does not affect the obligations of nondebtors (such as sureties and guarantors) with respect to claims against the estate. In effect, therefore, where the bankruptcy estate is not involved, the Bankruptcy Code's attitude towards intercreditor rights is one of non-involvement.[6]

Given this consistent pattern, there is no plausible reason to interpret § 506(c) as the single instance of Bankruptcy Code legislation which modifies the state law rights of nondebtor entities with respect to each other, as implied by petitioner's assertion that § 506(c) creates a private right of action for surcharge. The Bankruptcy Code is simply not

[6] To be sure, a bankruptcy court can resolve intercreditor rights, provided such resolution could have an impact on the bankruptcy estate and therefore would be within the "related to" jurisdiction of 28 U.S.C. § 157(a). *E.g.*, *Dogpatch Properties, Inc. v. Dogpatch U.S.A., Inc. (In re Dogpatch U.S.A., Inc.)*, 810 F.2d 782 (8th Cir. 1987) (bankruptcy court has "related to" jurisdiction over claims of a creditor against a nondebtor guarantor). In that situation, however, the substantive rights between the nondebtors are determined under applicable nonbankruptcy law, and not by the Bankruptcy Code. Petitioner, by contrast, would read § 506(c) as establishing a *substantive* right to surcharge.

concerned with the relationship among individual nondebtor entities, but only with the collective process for addressing creditor claims and rehabilitating financially troubled companies. See Thomas H. Jackson, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 7 (1986) ("All agree that [the bankruptcy law] serves as a collective debt-collection device."). It is for that reason, for example, that the avoidance rights of individual creditors under state law are vested in the trustee, to be utilized for the benefit of the estate as a whole. *Moore v. Bay (In re Sassard & Kimball Inc.)*, 284 U.S. 4 (1931) (mortgage void under state law as to certain creditors would be avoided for the benefit of all creditors); *see also* §§ 544 (trustee's "strong arm powers"); 548 (avoidance of fraudulent conveyances); 551 (preservation of avoided transfers and liens for the benefit of the estate). It would be anomalous indeed if the Bankruptcy Code which, in the avoidance context, appropriates creditor avoidance actions for the collective benefit of the estate, would in the surcharge context provide for surcharges by and for the exclusive benefit of individual creditors – especially through language which by its terms gives that surcharge right only to the trustee.

It is for this reason that the Bankruptcy Code, consistent with its literal language, contemplates that the trustee serve as the focal point for the claims of those who provide services to the estate, and be the one charged with the task, if appropriate, of seeking to surcharge secured creditors for those services. Entities which provide goods or services to the estate after the petition date are granted administrative claims under § 503 and are entitled to a priority in repayment under § 507, ahead of prepetition unsecured claims. Having contracted with the estate, these entities are to look to the estate for payment – and it is hardly unfair that the Bankruptcy Code gives them no additional rights, beyond

those which they might otherwise have under state law, to obtain payment for those services from anyone else, including secured creditors. The trustee for the estate, in turn, is empowered under § 506(c) to surcharge collateral for the benefit conferred on the secured creditor by the trustee's incurring of those administrative expenses. Contrary to the assertion of petitioner and certain lower courts,[7] the trustee has every incentive (as well as the fiduciary duty) to pursue meritorious § 506(c) claims for the benefit of the estate, because any recovery would be used to defray unpaid administrative claims or provide recovery for prepetition creditors. But there is nothing in this scheme which suggests that § 506(c) allows unsecured creditors to ignore the trustee, and independently pursue new Bankruptcy Code-created causes of action against secured creditors.

[7] Petitioner's Brief at 43-46; *Equitable Gas Co. v. Equibank, N.A. (In re McKeesport Steel Castings Co.)*, 799 F.2d 91, 94 (3[d] Cir. 1986).

III. PETITIONER'S INTERPRETATION IS INCONSISTENT WITH THE GENERAL BANKRUPTCY PRINCIPLE THAT LIENS ARE TO PASS THROUGH BANKRUPTCY UNAFFECTED

Petitioner's assertion that § 506(c) was intended to create a private right of action for surcharge is also inconsistent with the limited extent to which the Bankruptcy Code purports to affect the rights of secured creditors. As this Court recognized in *Dewsnup v. Timm*, 502 U.S. 410, 418-20 (1992), an underlying principle of both the Bankruptcy Code and its predecessor statutes is that liens pass through the bankruptcy case unaffected. *See also Long v. Bullard*, 117 U.S. 617 (1886); *FDIC v. Union Entities (In re Be-Mac Transp. Co.)*, 83 F.3d 1020, 1025, 1027 (8th Cir. 1996) (secured claim survives bankruptcy even though proof of claim was denied as untimely; liens survive unless extinguished under a plan in which creditor participates).

Given this fundamental premise, when the Bankruptcy Code seeks to affect the rights of secured creditors, it does so both narrowly and explicitly. This largely occurs in two sets of provisions, one of which seeks to establish the dimensions of the secured claim, and the other which deals with how the

secured claim must be treated.[8] The latter is exemplified by provisions like § 1129(b)(2)(A), which require that the secured creditor retain its liens and receive a distribution which, in essence, is the "indubitable equivalent" of its secured claims. See also § 1124, which allows claims (including secured claims) to be treated as "unimpaired" by restoring the "legal, equitable, and contractual rights" of such claim after curing defaults. The thrust of these claim treatment provisions is that unless the secured creditor consents, it must receive the equivalent of its full nonbankruptcy entitlements – *i.e.*, that although its ability to obtain the benefit of its secured claim may be deferred in bankruptcy, ultimately it will be protected to the extent of the value of its collateral. *United Savs. Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1988).

The same solicitous and restrained approach towards secured creditors' rights is evident from the provisions addressing the determination of secured claims. Here, the governing principle is set forth in § 506(a), which defines a secured claim as equal to the value of the collateral which secures the debt. *See Nobelman v. American Savs. Bank*, 508 U.S. 324, 328 (1993) ("Section 506(a) provides that an allowed claim secured by a lien on the debtor's property 'is a

[8] In addition, secured claims are subject to the automatic stay provisions of § 362, enjoy rights of adequate protection under § 363(c), and can be subject to the avoidance provisions of §§ 544-51.

secured claim to the extent of the value of [the] property'; to the extent the claim exceeds the value of the property, it 'is an unsecured claim.'"). Section 506(b) further recognizes that to the extent of the value of the collateral, the secured creditor is entitled to all of its state law rights, including interest whether or not consensual. *Ron Pair,* 489 U.S. at 238-39. *See also Rake*, 508 U.S. at 470-73 (oversecured mortgages in chapter 13 entitled to interest on arrearages). And in valuing the collateral at the time of reorganization, this Court has recently recognized that the appropriate measure is not the low collateral value which the secured creditor could obtain at foreclosure, but the higher replacement value which the debtor would have to pay to acquire a similar asset from another source. *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997).

Each of these statutory provisions and decisions of this Court reflects the underlying premise of the Bankruptcy Code that except as explicitly provided in the statute, secured creditors' liens are to pass through bankruptcy unaffected. The statute and case law generally reflect a deferential approach towards secured creditors' substantive state law entitlements.

The Bankruptcy Code does recognize that sometimes, an increase in collateral value is not a function of the creditor's prepetition interests in the collateral itself, but rather results from expenditures by the bankruptcy trustee. The Code accordingly seeks to ensure that the secured creditor's claim is not enhanced at the estate's expense. This concept is reflected in § 552. Subsection 552(a) announces the general rule of cleavage – that a secured creditor's prepetition lien does not extend to property acquired by the estate after the petition date. Subsection 552(b) provides for the exception to that general rule. To the extent that the secured creditor's

claim includes proceeds, products, offspring or profits of collateral, it equally extends to proceeds, products, offspring and profits acquired by the estate postpetition, "except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise." This caveat is intended to encompass a situation "where raw materials, for example, are converted into inventory, or inventory into accounts, at some expense to the estate, thus depleting the fund available for general unsecured creditors . . ." H.R. Rep. No. 95-595 at 377 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5877. *See also* S. Rep. No. 95-989 at 91 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6333. In that instance, the secured creditor is not allowed a claim for the entire value of the inventory or accounts receivable because the estate is entitled to its share of the collateral value added through its expenditures.

Section 506(c) is a provision analogous to § 552(b). Section 506(c) provides that the creditors' collateral value is to be adjusted by the amounts expended by the estate to obtain such collateral value – "the reasonable, necessary costs and expenses of preserving, or disposing of, such property," but only "to the extent of any benefit" to the holder of the secured claim. The concept here is the same concept as in § 552(b). The secured creditor should not benefit from expenditures by the estate which enhance the value of its collateral, without accounting to the estate for the benefit it thereby received. Because the lien is to pass through bankruptcy unaffected, it should neither be reduced nor augmented as a result of the bankruptcy. But except for the limited circumstances in §§ 506(c) and 552(b) in which the estate has expended funds to enhance the collateral, "[a]ny increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor." *Dewsnup*, 502 U.S. at 417.

Section 506(c) is thus similar to § 552(b) in that each is directed at the relationship between the secured creditor and the estate. Section 506(c) is part of a section entitled "Determination of Secured Status," and follows subsections which define the secured claim in terms of its collateral value (§ 506(a)) and require that the entire collateral value be dedicated to satisfying the secured creditor's state law rights, including postpetition interest and applicable fees and charges (§ 506(b)). Like § 552(b), the purpose of § 506(c) is to require a surrender back to the estate of some portion of the value of the collateral – the benefit resulting from the estate's expenditures. For that reason, § 506(c) is phrased in terms of a recovery by the representative of the estate, the trustee. But there is nothing in § 506(c) which remotely suggests that it was intended to establish a new rule of intercreditor distributions, let alone create a new rule of subordination of the rights of secured creditors to the unpaid providers of workers' compensation insurance or other postpetition services to the debtor. If Congress intended to establish such a new subordination right, the place to do so was as part of the subordination provisions of § 510, and not in § 506, which is devoted to defining the scope of a secured creditor's claim vis-à-vis the estate, and not vis-à-vis other creditors.[9]

[9] Both petitioner and its *amici* cite certain pre-Code cases in which third parties pursued surcharge claims against secured creditors' collateral. There is no indication in any of these cases that the standing question was raised, so they are slender support for petitioner's argument here.
footnote continued on next page

In sum, to the extent that petitioner may have a claim against respondent under applicable nonbankruptcy law, that claim is preserved under the Bankruptcy Code, and may even be cognizable under the bankruptcy court's "related to" jurisdiction in 28 U.S.C. § 157(a). See *Commerce Bank, N.A. v. Tifton Aluminum Co.*, 217 B.R. 798, 800-02 (W.D. Mo. 1997) (deciding unjust enrichment claim against secured creditor under "related to" jurisdiction). But that is a far cry from petitioner's assertion that § 506(c) was intended to create a private right of action for surcharge which would afford petitioner broader rights than those otherwise available to it under applicable nonbankruptcy law. Given the general

In any event, these handful of cases in which surcharge claims were pursued without the participation of the trustee are isolated ripples among the waves of litigated cases in which trustees were involved, which generally focused on whether the expenses in question were preservation costs chargeable to the secured creditor or general costs of administration which were not. *See generally* 4B COLLIER ON BANKRUPTCY ¶ 70.99[6], at 1223-43 (James Wm. Moore, *et al.*, eds., 14th ed. 1978). Thus, these pre-Code citations fall far short of supporting petitioner's position that there was a longstanding history of surcharges by non-trustees which Congress intended to perpetuate, and the legislative history gives no indication that Congress was aware of the cases which petitioner has now managed to find. See, *e.g.*, S. Rep. No. 95-989 at 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5854 ("Subsection (c) also codifies current law by permitting *the trustee* to recover from property . . . the reasonable, necessary costs and expenses of preserving, or disposing of, the property.") (emphasis supplied).

thrust of the bankruptcy laws that secured creditors' lien rights pass through bankruptcy unaffected, any Congressional enactment to curtail those lien rights needs to have been explicit. That explicitness is not supplied by § 506(c), which by its terms is limited to the surcharge rights of the trustee.

IV. THE ADMINISTRATIVE PRIORITY WHICH PETITIONER SEEKS IS WITHOUT SUPPORT IN THE BANKRUPTCY CODE, AND WOULD LEAD TO ANOMALOUS AND CONTRADICTORY OUTCOMES

By asserting a unique right to surcharge respondent's collateral, petitioner seeks to obtain full payment of its administrative claim from respondent while other administrative creditors go unpaid. In essence, petitioner seeks to craft a priority for its administrative claim ahead of other administrative priorities. In this additional respect, petitioner's argument conflicts with the structure of the Bankruptcy Code.

Congress knew how to establish schedules of claim priorities. An extensive list of such priorities, designated from "First" to "Ninth," is set forth in § 507, and further implemented through the liquidation priority provisions of § 726 and the reorganization provisions requiring full payment of administrative claims under § 1129(a)(9) and specifying the priorities of other claims under § 1129(b). Congress also knew how to create "superpriority" administrative claims, which would come ahead of other administrative claims, as it did under § 507(b) for secured creditors whose adequate protection proved inadequate. Congress further knew how to create even higher priorities as needed for the estate to obtain postpetition credit, and authorized in § 364(c)(1) the awarding of administrative

claims with priority over those in § 507(b), as well as the grant of new liens or junior liens under § 364(c)(2) and (3) and even priming liens under § 364(d).

It is striking, therefore, that in the litany of all these statutory priorities, Congress nowhere set forth a priority status in bankruptcy for entities like petitioner which furnish services that allegedly benefit a secured creditor's collateral. Given the dominant role which creditor priorities play in bankruptcy – one of whose main goals is effecting creditor distributions – and Congress' explicitness in scheduling such priorities elsewhere in the Bankruptcy Code, petitioner's contention that such a priority was implicitly created by § 506(c), which by its terms is limited to trustees, strains all credibility. *Cf. United States v. Noland*, 517 U.S. 535 (1996) (refusing to imply claim priorities not expressly set forth by Congress).

In addition, petitioner's contentions would lead to absurd and contradictory results. Petitioner would doubtless agree that an action to surcharge collateral can be brought by the trustee, because that is exactly what the literal terms of the statute provide. If the trustee brings such an action, however, any recovery by the trustee would become property of the estate, and be used to pay claims in accordance with their statutory priority, on a *pro rata* basis within each priority class. See § 726(b) (requirement of payment of claims "pro

rata among claims of the kind specified in each such particular paragraph").[10] On the other hand, under petitioner's theory, petitioner can also bring a surcharge action, but if it does, it can retain any recovery for itself. See Petitioner's Brief at 43-46 (arguing that only petitioner has the incentive to pursue a claim for its own benefit). Why should the entity receiving the recovery depend on who brings the action? And what happens if *both* the trustee and petitioner seek to bring the § 506(c) claim – who should be allowed to pursue the action, and who should receive any resulting recovery? See, *e.g.*, *In re Bluffton Castings Corp.*, 224 B.R. 902 (N.D. Ind. 1998) (conflicting § 506(c) claims filed by trustee and unsecured creditors; unsecured creditors denied standing). The fact that the statute provides no solution to these fundamental conceptual and practical difficulties is further evidence that petitioner's interpretation of § 506(c) cannot be sustained.[11]

[10] Petitioner (Brief at 45) argues that if the trustee pursues the § 506(c) claim, it must dedicate any recovery to the unpaid administrative expense creditor whose services gave rise to the right of surcharge. No statutory support is adduced for this proposition, and it is contrary to the express requirements for *pro rata* distribution contained in § 726(b). (Because §§ 943(b)(5), 1129(a)(9) and 1322(a)(2) each provide for payment in full of all administrative expenses, a surcharge claim by an administrative creditor will arise only where the estate is to be liquidated under chapter 7, in which event the distribution scheme of § 726(b) will come into play.) *Amici* American Insurance Association and National Union (Brief at 18-19) argue that administrative expenses are not subject to any rule of *pro rata* distribution. However, the cases they cite stand only for the proposition that once paid, administrative expenses other than legal fees should not be subject to a rule of disgorgement, but otherwise recognize the general rule, applicable to any unpaid administrative expenses, of *pro rata* distribution. *E.g.*, *In re Vernon Sand & Gravel, Inc.*, 109 B.R. 255, 257 (N.D. Ohio 1989).

[11] There is, of course, well-established precedent in bankruptcy that parties can be authorized to pursue actions belonging to the estate. This occurs, for example, when creditors committees or even individual creditors are authorized to pursue avoidance or other actions which, for whatever reason, the trustee is unwilling or unable to pursue. *E.g.*, *Coral Petroleum, Inc. v. Banque Paribas-London*, 797 F.2d 1351, 1362-63 (5th Cir. 1986) (creditors committee has standing to pursue preference action which trustee declined to pursue); *Canadian Pac. Forest Prods., Ltd. v. J.D. Irving, Ltd. (In re The Gibson Group, Inc.)*, 66 F.3d 1436 (6th Cir. 1995) (standing to individual creditor). In those instances, however, any recovery is not, as petitioner suggests here, for the benefit of the party pursuing the action, but for the benefit of the estate. *Coral Petroleum, supra*, 797 F.2d at 1363 (prosecution of preference claim for the protection of unsecured creditors' interests); *Gibson Group, supra*, 66 F.3d at 1438, 1446 (claims being pursued "that would benefit the estate if successful").

V. IF ADOPTED, THE RULE WHICH PETITIONER ADVOCATES WOULD ADVERSELY IMPACT THE BANKRUPTCY PROCESS AND DEBTORS' OPPORTUNITIES FOR REHABILITATION

One of the important goals of bankruptcy is to provide an opportunity for a debtor's reorganization. To accomplish that objective, secured creditors are required to forego exercising their rights of foreclosure so the debtor can try to rehabilitate. Frequently, secured creditors and debtors enter into consensual arrangements ("cash collateral orders") for postpetition use of the creditor's collateral under § 363, including provisions for adequate protection of the secured creditor's interests under § 363(e). (Such agreements may be accompanied by agreements for additional postpetition financing under § 364.) These cash collateral orders typically include provisions, similar to those included in the cash collateral order below, which provide that the collateral will not be subject to surcharge under § 506(c) without the secured creditor's consent. *Hartford Underwriters Ins. Co. v. Magna Bank, N.A. (In re Hen House Interstate, Inc.)*, 150 F.3d 868, 870 (8th Cir. 1998), *rev'd*, 177 F.3d 719 (8th Cir. 1999) (*en banc*). Through such consensual cash collateral arrangements, secured creditors are able to obtain some protection for their positions while debtors are given an opportunity to seek to reorganize and provide some recovery for their unsecured creditors and possibly shareholders.

The rule which petitioner advocates, however, would subject secured creditors to surcharge claims by any entity which provided postpetition goods and services to a debtor and remained unpaid, irrespective of the terms of any cash collateral order. Under petitioner's theory, and as the original panel decision held, because respondent agreed to the continued operation of the debtor's business, it is deemed to

agree "to accept the expenses and risks" associated with that continued operation. *Id.* at 872. Under such circumstances, secured creditors will be hesitant to accommodate debtors' requests that they defer foreclosure, lest they be tagged with the unpaid administrative costs of a failed reorganization. In many cases, as a consequence, secured creditors will not enter into agreed cash collateral orders, resulting in litigation as to the nonconsensual use of cash collateral, with attendant cost, delay, and disruption to debtors' businesses in the critical early stages of the case. In some percentage of those cases, moreover, the secured creditor will be granted relief from the stay, and the opportunity of the debtor to reorganize will be precluded. None of this is consistent with sound bankruptcy policy, but it will result from adoption of petitioner's position.

CONCLUSION

For all the foregoing reasons, the Commercial Finance Association prays that the *en banc* decision of the Eighth Circuit be affirmed.

Respectfully submitted,

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