No. 10-422

IN THE
Supreme Court of the United States

IN RE: EXIDE TECHNOLOGIES,

Debtor.

EXIDE TECHNOLOGIES,

Petitioner,

v.

ENERSYS DELAWARE, INC.,

Respondent.

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

REPLY BRIEF OF PETITIONER

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REPLY ARGUMENT

I. CONTRARY TO ENERSYS'S ARGUMENT, THERE IS A GENUINE CONFLICT OVER THE TEST USED TO DETERMINE WHETHER A CONTRACT IS EXECUTORY UNDER SECTION 365 OF THE BANKRUPTCY CODE.

A. The Sixth Circuit has Adopted, and Continues to Apply, the Functional Test.

The functional test is binding within the Sixth Circuit. Indeed, EnerSys does not dispute that the Sixth Circuit adopted that test. Opp. at 14-18. Nor could it. As Exide explained, the Sixth Circuit adopted the functional test in *In re Jolly*, 574 F.2d 349 (6th Cir. 1978), *cert. denied*, 439 U.S. 929 (1978), and reaffirmed its adherence to that test in *In re Becknell & Crace Coal Co.*, 761 F.2d 319 (6th Cir. 1985), *cert. denied sub nom.*, *Sloan* v. *Hicks*, 474 U.S. 1006 (1985). Pet. at 14-15.

Normally, a court of appeals must sit *en banc* to overrule a panel decision, but EnerSys contends that, in *In re Terrell*, 892 F.2d 469 (6th Cir. 1989), a three-judge panel somehow overruled *Jolly* and *Becknell*. Opp. at 15-16. The Sixth Circuit has never embraced EnerSys's reading of *Terrell*. Moreover, the only two lower-court cases cited by EnerSys that post-date *Becknell* appear unaware of that decision or the Sixth Circuit's more recent statement—again reaffirming the functional test—in *In re Magness*, 972 F.2d 689 (6th Cir. 1992). Opp. at 16 (citing *In re Ravenswood Apartments, Ltd.*, 338 B.R. 307, 311

(B.A.P. 6th Cir. 2006); *In re Nat'l Fin. Realty Trust*, 226 B.R. 586, 589 (Bankr. W.D. Ky. 1998)).

To be sure, *Terrell* stated that it was applying the material-breach test, but *Terrell* did not purport to overrule *Jolly* or *Becknell*, and, in fact, *Terrell* cited *Jolly* with approval. *Terrell*, 892 F.2d at 471-72. Moreover, lower courts within the Sixth Circuit have not struggled to reconcile *Terrell* with *Jolly* and *Becknell*. As one court explained: "The reason the *Terrell* court never undertook a functional analysis was because in that case, the [material-breach] test *alone* so clearly revealed the contracts in question were executory." *E.g., Phar-Mor, Inc.* v. *Strouss Bldg. Assocs.*, 204 B.R. 948, 952 n.2 (N.D. Ohio 1997); *see In re KY USA Energy, Inc.*, 439 B.R. 413, 415 (Bankr. W.D. Ky. 2010) (following *Jolly* even after *Terrell*); *In re Monarch Tool & Mfg. Co.*, 114 B.R. 134, 136-37 (Bankr. S.D. Ohio 1990). In short, *Terrell* did not—and could not—overrule the Sixth Circuit's adoption of the functional test.

In any event, even after *Terrell*, the Sixth Circuit has described the material-breach test as "helpful but not controlling," and emphasized that the functional test governs whether a contract is executory. *Magness*, 972 F.2d at 694. EnerSys attempts to cast aside this statement as *dicta*, Opp. at 15, 18, but the Sixth Circuit has stated, unequivocally, that the functional test is the governing test within its jurisdiction, *Magness*, 972 F.2d at 694, and, importantly, the lower courts have followed that statement in cases like *Phar-Mor*, *KY*, and *Monarch*.

B. The Eleventh Circuit has Likewise Adopted, and Recently Stated Its Continued Approval of, the Functional Test.

EnerSys does not dispute that, following a decision in which the Eleventh Circuit recognized, in *dicta*, the virtues of the functional approach, *In re Martin Bros. Toolmakers, Inc.*, 796 F.2d 1435 (11th Cir. 1986), that court later adopted, in *In re General Development Corp.*, a district court opinion, which, in turn, adopted the functional test, 84 F.3d 1364 (11th Cir. 1996). Opp. at 19-20. EnerSys contends, however, that *General Development* is not binding on courts within the Eleventh Circuit because it was issued as a *per curiam* opinion, and because this Court has stated that "'the precedential effect of a summary affirmance can extend no farther than the precise issues presented and necessarily decided by those actions.'" Opp. at 19-20 (quoting *Ill. State Bd. of Election* v. *Socialist Workers*, 440 U.S. 173, 182 (1979)). These arguments are mistaken.

The Eleventh Circuit's decision in *General Development* is not a mere summary affirmance. Rather, the court of appeals affirmed "on the basis of the opinion of the district court," appended that opinion as an expression of its own view, and published that expression in a reported opinion. 84 F.3d at 1365; *cf.* Opp. at 19 (citing *Ill. State Bd. of Election*, 440 U.S. at 182, which dealt with an order that merely said, "judgment affirmed"). This Court has not hesitated to view such an opinion as a binding expression of the law within a particular circuit. *E.g.*, *Davis* v. *Scherer*, 468 U.S. 183, 189 (1984) (explaining that the "Court of Appeals affirmed on the basis of the

District Court's opinion," but the Supreme Court still "noted probable jurisdiction to consider whether the *Court of Appeals* properly" decided the case (emphasis added; citation omitted)).[1]

Nor does *General Development*'s issuance as a *per curiam* opinion detract from the binding effect of that decision's holding. EnerSys does not cite a single case holding that a *per curiam* opinion is any less binding. Instead, it quotes selectively from a Supreme Court opinion, Opp. at 20 (quoting *Edwards* v. *Carpenter*, 529 U.S. 446, 452 n.3 (2000)), without revealing that it was the respondent in that case who had argued that "*per curiam* opinions decided without the benefit of full briefing or oral argument are of little precedential effect," and without revealing that the Court never adopted this argument, *Edwards*, 529 U.S. at 452 n.3.

In any event, the Eleventh Circuit has recently explained that it "approved," albeit "tacitly," the functional test and described *General Development* as a "precedent." *Tompkins* v. *Lil' Joe Records, Inc.*, 476 F.3d 1294, 1305 n.13 (11th Cir. 2007). Moreover, with one exception, courts within the Eleventh Circuit likewise consider themselves bound by *General Development*. *E.g.*, *In re Surfside Resort & Suites, Inc.*, 344 B.R. 179, 186 (Bankr. S.D. Fla. 2006); *In re Transit Group, Inc.*, No. 01-br-12820, 2002 WL 31940797, at *3 (Bankr. M.D. Fla. Nov. 25, 2002); *In re Nix*, No. 96-br-42948, 1997 WL 33419263, at *4

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[1] *See also Hensley* v. *Eckerhart*, 461 U.S. 424, 429 (1983) (certiorari was granted to review a decision of the court of appeals "affirm[ing] on the basis of" a district court opinion); *accord Connick* v. *Myers*, 461 U.S. 138, 142 (1983).

(Bankr. S.D. Ga. Aug. 26, 1997). The only exception cited by EnerSys (Opp. at 21) is a lower court decision in which the bankruptcy court did not apprehend that, once the Eleventh Circuit adopted the district court's opinion in *General Development* as its own, the district court's predictive statement—that the Eleventh Circuit was likely to adopt the functional test—was no longer predictive, but rather, the functional test had become the law of the circuit, *see In re W.B. Care Ctr., LLC*, 419 B.R. 62, 70 (Bankr. S.D. Fla. 2009). There is no doubt that the Eleventh Circuit—like the Sixth—continues to adhere to the functional test, which is in conflict with the seven circuits that adhere to the material-breach (or Countryman) test. Pet. at 17-19.[2]

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[2] EnerSys argues that the Eleventh Circuit's functional test differs from that of the Sixth Circuit, because, in EnerSys's view, the Eleventh Circuit adopted a criticalness component. Opp. at 13-14. But that argument fails for two reasons. First, this Court has rejected any argument that requires a debtor to demonstrate that "reorganization will fail unless rejection is permitted." *NLRB* v. *Bildisco & Bildisco*, 465 U.S. 513, 524 (1984). Second, the Eleventh Circuit's statement—that rejection was "critical" to the debtor's reorganization—was descriptive, not a component of the test it adopted. *Gen. Dev.*, 84 F.3d at 1374. Indeed, the Eleventh Circuit adopted the Sixth Circuit's articulation of the functional test, and that articulation does not turn on whether rejection is "critical" to the debtor. *Id.* at 1375 (citing *Becknell*, 761 F.2d at 322).

II. RESPONDENT'S OPPOSITION DOES NOT UNDERMINE THE IMPORTANCE OF THE QUESTION PRESENTED HEREIN.

A. The Question of Which Test Applies—the Functional or Material-Breach Test—is Meaningful and Important to the Rehabilitation of Debtors and to Creditors at Large.

EnerSys argues that the difference between the functional and material-breach tests is not important because, in cases where there is a material breach, the result would be the same under either test. Opp. at 24-28. This argument is as unconvincing as it is mistaken. The difference between which test applies is meaningful and important to the rehabilitation of the debtor and to the interests of creditors at large, even if there is some overlap between the tests.

The functional test unquestionably matters in every case where one party's nonperformance would not excuse the other's, and the question whether a breach is material is a frequently litigated issue. Those facts alone demonstrate that nonperformance under a contract will often fall short of constituting a material breach, and therefore, the contract will be subject to rejection or assumption only if the functional test is deemed to apply. And because the question of which contracts are executory is a recurring one, and often involves commercial contracts that could be valued at tens of millions of dollars, the

difference between which test applies is likely in the order of billions of dollars.[3]

Moreover, under EnerSys's view, if a contract is not executory, and therefore not subject to rejection, then the beneficiary of that contract is entitled to the full value of the estate's performance. Such a holding would have a profound effect on any remaining creditors, because they will be forced to bear the full cost of the debtor's continued performance. Indeed, EnerSys is effectively arguing that, unlike other unsecured creditors, it should be entitled to the full amount the debtor owes to it, rather than its *pro rata* share of the debtor's bankruptcy estate. *Cf. Bildisco*, 465 U.S. at 531 ("Damages on the contract that result from the rejection of an executory contract . . . must be administered through bankruptcy and receive the priority provided general unsecured creditors.").

Finally, in a misguided effort to demonstrate that the differences between the tests are meaningless, EnerSys goes so far as to argue that rejection is, itself, meaningless. Opp. at 28-29. But this argument is based on a fundamental misunderstanding of the rejection power, which constitutes a pre-petition

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[3] The frequency with which an issue is discussed in reported bankruptcy decisions does not necessarily reflect the importance of that issue, because only one in 1580 bankruptcy cases generates an appeal. Troy McKenzie, *Judicial Independence, Autonomy, and the Bankruptcy Courts*, 62 Stan. L. Rev. 747, 783 (2010). Moreover, because negotiation remains the "lifeblood" of bankruptcy, rules that are not frequently reviewed can still have a profound effect on the settled expectations of parties in bankruptcy. *Id.* at 784.

breach, and, in combination with discharge, converts the damages associated with that breach into a "claim," 11 U.S.C. § 101(5), generally precludes the creditor from seeking specific performance, *id.* § 101(5)(B); *Ohio* v. *Kovaks*, 469 U.S. 274, 278-79 (1985), and relieves the debtor of its performance obligation upon confirmation of the plan, *Bildisco*, 465 U.S. at 532 ("the filing of the petition in bankruptcy means that the collective-bargaining agreement is no longer immediately enforceable, and may never be enforceable again," because that agreement was subject to rejection as an executory contract).

B. The Material-Breach Test is Inconsistent with Congressional Intent and Turns on an Arbitrary State-Law Distinction Divorced from the Purposes of the Bankruptcy Code.

EnerSys also argues that the rigid, material-breach test is somehow consistent with the text, history, and purposes of the Bankruptcy Code, Opp. at 32-34, but its argument is devoid of any meaningful analysis. Specifically, EnerSys argues that because the text of the statute limits rejection and assumption to *executory* contracts, and because Congress indicated that "executory" contracts "generally include[] contracts on which performance remains due *to some extent* by both parties," S. Rep. No. 95-989, at 58 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5844 (emphasis added), Congress somehow expressed its intent to adopt the material-breach test over the more flexible, functional test, Opp. at 33. But the text itself expresses no preference between tests, and the legislative history disavows any approach that

purports to offer a "precise definition of what contracts are executory." S. Rep. No. 95-989, at 58, *reprinted in* 1978 U.S.C.C.A.N. at 5844.

Moreover, EnerSys does not explain how the rigid, material-breach test promotes any of the basic purposes of the Bankruptcy Code—to provide bankruptcy courts with flexibility, to rehabilitate the debtor, and to ensure uniform treatment of similarly-situated creditors. That is because the material-breach test promotes none of these purposes. It strips bankruptcy courts of needed flexibility. *Cf. Bildisco*, 465 U.S. at 525 (rejecting an approach because it was "fundamentally at odds with the policies of flexibility and equity built into Chapter 11 of the Bankruptcy Code"). It prevents debtors from shedding burdensome obligations simply because the nonperformance of those obligations would not excuse the other party's performance. *Cf. id.* at 527 (the ultimate "policy of Chapter 11 is to permit successful rehabilitation of debtors"). And it treats similarly-situated creditors differently, because, under the material-breach test, a variable state-law standard determines which contracts can be rejected (Pet. at 22-24) and, therefore, which creditors are relegated to "the priority provided general unsecured creditors." *Bildisco*, 465 U.S. at 531.

EnerSys also argues that the material-breach test introduces "objectivity and consistency," Opp. at 34, but EnerSys ignores the widespread difficulty and disparity that even its own cases have recognized in applying that test. *Terrell*, 892 F.2d at 472 n.6 (differences in state law produced disparate outcomes for similar contracts); *In re Kane*, 248 B.R. 216, 223

(B.A.P. 1st Cir. 2000) (courts have "struggled with the specific issue of whether installment land sales contracts are executory" under the material-breach test, and "a split of authority has developed"); *Nat'l Fin. Realty Trust*, 226 B.R. at 589 (option agreements have "puzzled" and divided courts); *In re Cardinal Indus., Inc.*, 146 B.R. 720, 725 (Bankr. S.D. Ohio 1992) (describing the caselaw as "a hopelessly convoluted and contradictory jurisprudence").

III. RESPONDENT'S VEHICLE ARGUMENTS ARE UNAVAILING.

A. Exide has Consistently Claimed that the Contract at Issue is Executory and Therefore has Not Waived any Argument in Support of that Claim.

EnerSys's waiver argument is meritless. Opp. at 10-11. Importantly, EnerSys does not dispute that, at each stage below, Exide consistently claimed that the contract at issue in this case is executory. Under a litany of Supreme Court cases, because Exide consistently claimed that the contract is executory, it is allowed to "make any argument in support of that claim; [it is] not limited to the precise arguments [it] made below." *Citizens United* v. *Fed. Election Comm'n*, 130 S. Ct. 876, 893 (2010) (brackets and quotation marks omitted); *accord Harris Trust & Sav. Bank* v. *Salomon Smith Barney, Inc.*, 530 U.S. 238, 245 n.2 (2000); *Lebron* v. *Nat'l R.R. Passenger*

Corp., 513 U.S. 374, 379 (1995). EnerSys's cases are readily distinguishable. Opp. at 11.[4]

B. A Related Proceeding in the Bankruptcy Court Does Not Obviate the Need for this Court to Resolve the Question Presented Herein.

EnerSys also argues that a related proceeding could obviate the need for this Court to resolve the question presented here, rendering this case a "poor vehicle." Opp. at 30-31. Specifically, EnerSys argues that, because Exide needed to seek a declaration of the parties' rights under the plan confirmed by the Bankruptcy Court, that declaration could obviate the need for this Court to resolve "whether the Agreements [at issue here] are executory." *Id.* at 31. This argument should be rejected.

EnerSys's supposed vehicle problem would exist in any bankruptcy case in which a court has held that an agreement is not executory and therefore not subject to rejection. As a result, this case is as effective a vehicle as any other case in which a debtor

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[4] *E.g.*, *Granite Rock Co.* v. *Int'l Bhd. Of Teamsters*, 130 S. Ct. 2847, 2861 & n.14 (2010) (argument waived because *respondent* failed to raise it in opposition to the petition for a writ of certiorari (citing S. Ct. R. 15.2)); *United States* v. *Alvarez-Sanchez*, 511 U.S. 350, 360 n.5 (1994) (new Fourth Amendment claim waived because respondent only pressed a Fifth Amendment claim below); *Taylor* v. *Freeland & Kronz*, 503 U.S. 638, 645-46 (1992) (argument waived that was raised by petitioner "for the first time in his opening brief," because it was not "'fairly included'" in the questions presented in the petition, and because it would have "change[d] the substance of th[os]e questions'" (quoting S. Ct. R. 14.1(a), 24.1(a))).

seeks to reject a contract. In fact, because this case turns on which test applies, Pet. at 26-27, it is actually better than other cases at presenting the issue in conflict.[5]

Moreover, bankruptcy tends to discourage appellate review, because few debtors survive Chapter 11, and because fewer still have the time or the resources to pursue prolonged litigation. McKenzie, *supra* note 3, at 782. Forcing Exide to seek a post-confirmation declaration, rather than review in this Court, is not an equivalent remedy because it undermines Congress's "intention that business reorganizations should be quicker and more efficient and provide greater protection to the debtor, creditors, and the public interest." *Bildisco*, 465 U.S. at 517 n.1. This Court should resolve the issue in conflict now.

C. There is No Viable Alternative Ground for Affirmance.

Finally, EnerSys briefly argues that this case is a poor vehicle because section 365(n) provides an alternative basis for affirmance. Opp. at 29 & n.11, 32. However, as Exide explained, section 365(n) does not apply here, because it does not reach trademarks, trade names, and other propriety marks. Pet. at 27-28. It therefore provides no alternative basis for affirmance.

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[5] The contract at issue imposes obligations on both parties, and the obligations that it imposes on the estate are onerous and burdensome—particularly Exide's obligation to refrain from using a trademark bearing its own name in connection with a major segment of its business. Pet. App. 34a-35a, 44a-53a.

CONCLUSION

For the foregoing reasons and those stated in the petition for a writ of certiorari, the petition should be granted.

Respectfully submitted.

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