No. 13-16

In the Supreme Court of the United States

STANLEY MARVIN CAMPBELL,
Petitioner,

v.

THE HANOVER INSURANCE COMPANY,
Respondent.

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

REPLY IN FURTHER SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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INTRODUCTION

This petition for *writ of certiorari* ("Petition") asks the Court to settle the question of what evidentiary standard courts should employ in evaluating the "new value" defense under 11 U.S.C. § 547(c)(1). Must courts determine the *specific value* provided to the estate, as the Third, Fifth, Ninth, Tenth and Eleventh Circuits have held, to conclude that the "new value" provided equals or exceeds the value transferred out of the estate? Or is a *mere approximation* of the value sufficient to establish a party's right to the "new value" defense, as the Fourth Circuit below and the Eighth Circuit, as well as inconsistent Third and Tenth Circuit decisions, have held?

11 U.S.C. § 547(a)(2) defines "new value" to mean the *"money or money's worth*" provided by the transferee (emphasis added). The plain language of the statute demonstrates that Congress intended to make the "new value" defense available only where a transferee could prove that the specific "money or money's worth" transferred into the estate equaled or exceeded the value transferred out of the estate.

Most Circuits to consider the issue have applied the "new value" defense rigorously, requiring

specific proof of the actual value provided by the transferee. The Fourth Circuit below, joining the Eight Circuit and inconsistent panels of the Third and Tenth Circuit, applied the "new value" defense without requiring any evidence of the specific "money or money's worth" transferred to the estate. Instead, the Fourth Circuit below used the face value of the government contracts that Respondent *insured* as an approximation of the value Respondent provided, without requiring any determination of the value of the bonds Respondent *actually provided*. Just as a fire insurance policy on a $400,000 house costs far less than $400,000, the market value for surety bonds *insuring* performance on government contracts is far less than the extrapolated gross revenue of the contracts insured.

Respondent calls the split among the circuits on the evidentiary standards for the new value defense a "fabricat[ion]". Brief in Opposition at 3. But the split is no fabrication. Some federal courts require a determination of the specific dollar amount of new value provided to the estate, and some do not. Petition at 9-16.

The evidentiary standard is fundamental to bankruptcy law. Requiring specific proof of the "money or money's worth" in "new value" puts the burden where it properly belongs, on the creditor asserting new value as an affirmative defense. Allowing a creditor to claim "new value" without submitting evidence of the actual "money or money's

worth" provided (as the statute requires) defeats a purpose of the bankruptcy laws by allowing one creditor to loot the estate during the preference period to other creditors' detriment. That is precisely what Respondent did in this case, by demanding a letter of credit to cross-collateralize both new bonds and old bonds (which plainly did not provide any additional value to the estate) and extracting $1.375 million from the debtor during the preference period.[1]

A. THE CIRCUIT COURTS DIFFER ON THE EVIDENTIARY STANDARDS FOR THE NEW VALUE DEFENSE

Respondent's primary argument in opposition to the Petition is the contention there is no circuit split because all Circuits purport to require specific evidence of new value. Respondent's position deliberately elides Petitioner's point – which is that,

[1] Respondent's opposition fails to address the fact that Respondent actually took money from the estate in two transactions – *first*, by demanding a $74,701 fee for the bonds themselves, and *second*, by capturing $1.375 million under the letter of credit. Although Respondent never submitted any evidence regarding the value of its bonds, the logical inference is that the market value of the bonds is reflected by the *fee Respondent actually charged* for the bonds (*i.e.*, $74,701, which approximates the actual "new value" provided by the bonds), not the entire amount of the letter of credit that cross-collateralized old bonds as well as new (which is a classic preferential transfer).

despite paying *lip service* to the requirement to prove new value with specificity, the Fourth Circuit actually required *no specific evidence of new value at all*.[2]

Respondent attempts unsuccessfully to

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[2] Respondent asserts, gratuitously and incorrectly, that Petitioner mischaracterized the Fourth Circuit's opinion and should be sanctioned (Brief in Opposition at 15-19). Respondent's allegation has no basis in fact, and is an example of how willing Respondent is to shade the truth to elevate its interests over those of the estate. The Petition noted unequivocally that the Fourth Circuit cited the "specificity" standard but proceeded to require no specific proof of the new value Respondent actually provided. The relevant section of the Petition is reproduced below:

> While the Fourth Circuit cited the "specificity" evidentiary standard set forth in *Jet Florida* and *Spada* the Fourth Circuit in fact adopted and applied the minority view (*i.e.*, the Third Circuit in *Kumar Bavishi*, the Tenth Circuit in *Rodman* and the Eighth Circuit in *Jones Truck Lines*), and permitted Hanover to retain the full value of the funds it extracted, without identifying the alleged "money or money's worth" Hanover had provided in return. Instead, the panel majority merely compared the *face value* of the bonds it provided — *i.e.,* the revenue ESA expected to receive from the projects secured by those bonds, not the value of the bonds themselves — with the cost to the estate, without making any determination of the New Bonds' actual "money's worth"[.]

Petition at 17.

harmonize the principal outlier opinion from the Third Circuit – *Reigle v. Mahajan* (*In re Kumar Bavishi & Associates*), 906 F.2d 942 (3d Cir. 1990) – with the other circuit opinions and the majority opinion from the Fourth Circuit here. Respondent summarizes the *Kumar* opinion with this claim:

> [T]he Third Circuit did make a *specific* determination of the actual new value by holding that "[t]he debtor received $200,000 in cash as a result of appellee's guarantee." It was unnecessary for the Court to undertake any further "specificity" analysis as the transfer was one of *money* by the bank to the debtor, and no "valuation" is necessary with regard to a cash transfer.

Brief in Opposition at 10 (emphasis in original).

The portion of the *Kumar* decision cited by Respondent shows in stark relief the failure of the Third Circuit to require specific proof of the "money or money's worth" provided by the transferee asserting a "new value" defense. The Third Circuit did not determine the actual value that the creditor provided to the estate by signing a guarantee for a $200,000 loan. Instead, the Third Circuit used the *guaranteed amount—i.e.*, $200,000—without requiring any proof of the *actual value of the guarantee*. The actual value of that guarantee, at

the time delivered, was not $200,000. The loan—promising a specific return on capital at a set interest rate—had a discernible net present value, absent the guarantee. The guarantee, as a separate instrument from the loan, had a separate and distinct "money's worth".

The *Kumar* court erred by failing to determine precisely the specific value of the guarantee, as opposed to the value of the loan.[3] Instead, the *Kumar* court reasoned (like the majority of the Fourth Circuit here) that the value of the guarantee was "sufficient" to account for the $33,000 the creditor extracted from the estate at the time of the guarantee and it need not go further to make an exact calculation. The majority concluded that this

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[3] The Third Circuit in its outlier decision in *Kumar* and the Fourth Circuit below have failed to recognize that the proper measure of a contingent obligation is the actual "money or money's worth" provided *by the transferee*—usually the purchase price for the surety bond, guarantee or other contingent obligation—not the face value of a contingent obligation insured by the transferee. The actual value of a contingent obligation is logically much less than its face value. A $1 million life insurance policy does not cost $1 million to obtain. A homeowner's insurance policy does not cost the entire market value of the house. A spin of a slot machine offering a $1 million jackpot does not require a $1 million wager. Here, surety bonds insuring $1.375 million of potential revenue (and costing a fee of $74,701) are not worth $1.375 million. In each case, the contingent obligation has a determinable market value, represented by the life insurance premium, home insurance premium, wager, or surety bonding fee actually paid by the party benefiting from the contingent obligation.

"back of the envelope" calculation was good enough to allow the creditor to assert the new value defense.

Dissenting from the *Kumar* decision, Third Circuit Judge Cowen identified the errors in the majority's analysis, focusing on the transferee's failure to proffer any evidence of the guarantee's specific "money's worth":

> Yet *the record before us reveals no evidence as to the money's worth in value of the Appellee's alleged guarantor service.* Although the majority waves its hands at what this actual value was, I am simply not convinced that this value is not either too indeterminate or speculative to serve as new value in this context, or, assuming such guarantor service does have some value, that such value would be equivalent to $33,333.
>
> At any rate, this Court's recent decision in *In re Spada*, 903 F.2d 971 (3d Cir. 1990), holds "that a determination [by the bankruptcy court] of how much 'new value' was involved in the exchange is mandated" by the statute. *Such a determination is necessary because the court must compare how much new value is given*

> *to the amount of the preferential transfer with the creditor*. . . .
>
> *In this case the bankruptcy court made no finding as to the value of the Appellee's alleged guarantor service to the debtor. Consequently, the court made no comparison of the relative values of the service and the preferential transfer. In fact, from the record before us it is clear that the Appellee utterly failed to offer proof as to the value of the alleged guarantor service provided to the debtor.* Since I "conclude that a creditor must, as a part of its section 547(c)(1) affirmative defense, prove the specific valuation of the 'money or money's worth in goods, services, or new credit' that the debtor received as 'new value' in the contemporaneous exchange," *Jet Florida*, 861 F.2d at 1559, I find, in keeping with this circuit's precedent, that the Appellee has not proven a section 547(c)(1) defense in this case.

In re Kumar Bavishi & Associates, 906 F.2d at 948-49 (Cowen, J., dissenting) (emphasis added).

The Fourth Circuit below made the same critical error as the Third Circuit majority in *Kumar*, "wav[ing] its hands" at the actual "money or money's worth" provided by Respondent without any proof of

the value in "money or money's worth" Respondent actually provided. *See id.* at 948-49.

Respondent's attempt to harmonize the Eighth Circuit's minority view with the majority's requirement of specificity also fails. As Petitioner noted in its original petition, in *Jones Truck Lines, Inc. v. Central States, Southeast and Southwest Areas Pension Fund (In re Jones Truck Lines, Inc.)*, 130 F.3d 323 (8th Cir. 1997), the Eighth Circuit rejected the trustee's argument that the creditor needed to "quantify" the new value provided, and instead "presumed" the value of the alleged new value assets, without making a precise determination of the actual "money or money's worth" provided by the transferee. The Eighth Circuit's rejection of the statutory requirement that a transferee asserting a "new value" defense prove the actual "money or money's worth" provided stands, with the decision below and the *Kumar* decision, in stark contrast to the majority of circuits.

In sum, Respondent's attempt to deny the inconsistency between circuits as to the "new value" defense—and thus to convince this Court to deny the Petition—mischaracterizes the law.

B. FOURTH CIRCUIT CHIEF JUDGE TRAXLER'S DISSENT ILLUSTRATES WHY THIS COURT SHOULD REVIEW THE FOURTH CIRCUIT'S DECISION

Conspicuously absent from Respondent's opposition is any discussion of the well-reasoned dissent below from Chief Judge Traxler. Chief Judge Traxler, like Third Circuit Judge Cowen in his dissent to the *Kumar* decision, pinpointed the majority's failure to assess the specific value of the purported "new value" provided.

In his dissent, Chief Judge Traxler focused on the statutory language and applied common sense to the facts in this case, writing:

> The Trustee contends that even assuming that the New Contracts constituted new value, "Hanover failed to present evidence of the extent of the new value." *Id.* I agree. . . .
>
> *Hanover does not argue, and could not argue, that it presented evidence that the New Contracts were goods or services that could be sold for at least $1.375 million in the marketplace*. Rather, Hanover contends that ESA received "new value" of at least $1.375 million in the form of the New Contracts because ESA expected to make that much profit by eventually completing its work under those contracts. But regardless of what Hanover hoped to eventually receive,

> *what it actually received was only a conditional promise to pay ESA money at some point in the future*. . . .
>
> [T]he facts of this very case demonstrate why *receipt of a conditional promise for payment at some indefinite future time does not constitute receipt of 'new value' in the amount of the promised payment*. In a "new value" transaction, the debtor's payment does not reduce the size of the estate because the money paid by the debtor is replaced by money, goods, services, new credit, or property releases of equivalent value. Here, in contrast, Hanover successfully obtained $1.375 million from the estate without replacing it with equal value. In so doing, Hanover jumped ahead of ESA's other unsecured creditors and received far more payment via the letter of credit than it otherwise could have received in bankruptcy.

App. at 25-28 (Traxler, J., dissenting) (emphasis added, footnotes and citations omitted).

Ignoring Chief Judge Traxler's dissent entirely, Respondent's opposition focuses not on the value of the *bonds Respondent provided*, but on the

face amount of the revenue in *the government contracts that the bonds secured*. *See* Brief in Opposition 15-16 ("Rather, the question before the Fourth Circuit was whether Hanover had met its burden 'to establish with specificity the exact measure of the new value received by ESA' when *it was awarded the New Contracts*.") (emphasis added). But Respondent did not provide the New Contracts to the estate. Respondent provided surety bonds. As explained by Chief Judge Traxler, the "new value" defense thus required Respondent to prove the specific value of the bonds it provided – separate from the value of the New Contracts, which Respondent did *not* provide.

The Fourth Circuit majority below, by allowing Respondent to maintain a "new value" defense without proving the specific "money or money's worth" of the bonds Respondent provided, misapplied the statute and erred in the same way as the Eighth Circuit and the Third Circuit's *Kumar* panel. The Fourth Circuit below ignored the language of 11 U.S.C. § 547(a)(2), deepening the circuit split concerning the evidentiary standard applicable to the "new value" defense. As the law now stands, a contingent obligation creditor could loot the estate of a debtor located in South Carolina (in the Fourth Circuit) without providing evidence of the value of the contingent obligation, while a creditor a few miles away in Georgia (in the Eleventh Circuit) would have to prove the specific "money or money's worth" provided, as the statute requires.

CONCLUSION

The bankruptcy court and Fourth Circuit erred, and the Fourth Circuit adopted the minority position, by failing to require that Respondent submit specific evidence of the value in "money or money's worth" it provided to the debtor's estate. Because the "new value" defense provides a critical and often-employed method for preferential transferees to defend against preference claims in bankruptcy, this Court should grant *certiorari* to clarify nationwide the evidentiary standard applicable to the "new value" defense.

Date: August 13, 2013

Respectfully submitted,

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