No. 14-481

In The
Supreme Court of the United States

NATIONAL HERITAGE FOUNDATION, INC.,

Petitioner,

v.

THE HIGHBOURNE FOUNDATION,
JOHN R. BEHRMANN, AND NANCY BEHRMANN,

Respondents.

**On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Fourth Circuit**

REPLY IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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INTRODUCTION

Respondents' Brief in Opposition ("Opp.") reinforces the two independent reasons why this Court should grant *certiorari*.

First, Respondents acknowledge that the Circuits are in conflict over whether a Chapter 11 Plan of Reorganization may contain releases in favor of nondebtors. The Fourth Circuit exacerbated that conflict by incorrectly applying the Sixth Circuit's *Dow Corning* test – a test designed to determine if Nondebtor Releases[1] are fair to a class of non-consenting *creditors* in a bankruptcy – instead to a "class" of non-creditor donors who donated to DAFs sponsored and maintained by NHF in exchange for a tax deduction. Such donors were not creditors of NHF, however, because, under the Internal Revenue Code they relinquished all right, title and interest in funds they donated, 26 U.S.C. §4966(d)(2)(A), and had no "right to payment," as the Bankruptcy Code requires for a "claim." 11 U.S.C. §101(5). Respondents argue that this conflict should be allowed to persist, relying on inapposite cases that hold that Bankruptcy law looks to state law to define the "contours" of property interests. (Opp.29) Yet federal law mandates that donors have *no* property interest, making state property law irrelevant. Because Nondebtor Releases may be essential to preserve a reorganized debtor as a going concern, the Nation's courts will continue to

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[1] This Reply uses terms defined in the petition.

struggle with how to determine whether they are enforceable until this Court resolves the existing conflict. This Court should grant *certiorari* to provide clear guidelines for lower courts to apply in assessing the enforceability of Nondebtor Releases.

Second, Respondents ignore the importance of this Court's holding in *Bank of America Nat'l Trust and Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 424 (1999), that a principal goal of a Chapter 11 bankruptcy is to preserve the reorganized debtor as a going concern. Respondents disregard facts found by the Bankruptcy Court that show that NHF's future is jeopardized if the Releases fail. They ignore the Bankruptcy Court's dispositive finding that, without the Releases, "multiple lawsuits" by NHF's donors are a "near certainty" that "could have a materially negative impact on the Debtor's ability to successfully complete its reorganization." (App.92-93) Respondents' own behavior proves that "certainty," as they pursue a lawsuit against NHF's officers and directors that already has cost NHF more than $1,000,000 to defend.

Respondents hope to dissuade this Court from granting *certiorari* by arguing that this is a "factually-intensive" and "garden-variety" bankruptcy case. (Opp.1, 2, 9) To the contrary, NHF accepts the facts found by the Bankruptcy Court on remand and seeks *certiorari* because of the Fourth Circuit's legal errors, which, if left to stand, will create insuperable problems for both Plan proponents in future bankruptcies

and for litigants in matters concerning charitable donations.

ARGUMENT[2]

I. This Case Shows The Need For This Court's Guidance To Resolve The Growing Circuit Conflict On This Nationally Important Issue.

Respondents try to minimize the existing Circuit conflict, suggesting that "perceived differences" among the Circuits are irrelevant because NHF's Releases allegedly fail under any standard. (Opp.27-28) This is untrue. Rather, by applying tests intended to protect the rights of non-consenting *creditors* to those who cannot be creditors, the Decision exacerbates the existing conflict by rejecting Nondebtor Releases when other Circuits would not have. Had the Fourth Circuit correctly applied the *Dow Corning* test to the facts found by the Bankruptcy Court on remand, it would have upheld the Releases.

[2] Respondents' Opposition contains numerous factual errors. One glaring misstatement is that the Fourth Circuit's Decision was issued *en banc*. Rather, NHF's Petition for Rehearing *En Banc* was denied. (App.171)

A. The Decision Improperly Extends Legal Protections For Creditors To Non-Creditors.

Respondents cannot dispute that the Circuits have adopted varying approaches in evaluating Nondebtor Releases. *See Airadigm Commc'ns, Inc. v. FCC (In re Airadigm Commc'ns, Inc.)*, 519 F.3d 640, 656 (7th Cir. 2008). The conflict exists on two levels. The first is between those Circuits that will allow Nondebtor Releases in appropriate circumstances and those – the Ninth and Tenth – that will not. Consistent with *Bank of America,* this Court should accept review to make clear that, in appropriate circumstances, like here, Nondebtor Releases are permissible where they are essential to a debtor's ability to remain a going concern and where the Plan protects the interests of non-consenting creditors.

The second level of conflict is among those Circuits, like the Fourth Circuit, that will permit Nondebtor Releases where, as here, unusual circumstances are shown. Until the Fourth Circuit's Decision, every Circuit that has allowed Nondebtor Releases has evaluated their enforceability by analyzing their impact on non-consenting creditors. The Second Circuit considers whether "a court may enjoin a *creditor* from suing a third party." *In re Metromedia Fiber Network, Inc.,* 416 F.3d 136, 141, 142 (2d Cir. 2005) (and noting that "[n]on-debtor releases may also be tolerated if the affected *creditors* consent") (emphasis added). The Third Circuit considers "whether the plan pays all or substantially all of the

affected parties' *claims*." *Gillman v. Cont'l Airlines, Inc. (In re Cont'l Airlines, Inc.)*, 203 F.3d 203, 217 (3d Cir. 2000) (emphasis added). The Seventh Circuit asks "whether a bankruptcy court can release a nondebtor from *creditor* liability over the objections of the *creditor*. . . ." *Airadigm*, 519 F.3d at 655 (emphasis added).

The Fourth Circuit claimed to rely on standards articulated by the Sixth Circuit in *Class Five Nevada Claimants v. Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002). But in promulgating this test, the Sixth Circuit stressed that it was concerned with the impact on creditors, stating that "when the following seven factors are present, the bankruptcy court may enjoin a *non-consenting creditor's* claims against a nondebtor." *Id.* at 658 (emphasis added). Respondents quote the test itself, but ignore this preamble. (Opp.15)

However, the Fourth Circuit invalidated the Releases in NHF's Plan, not because of how they impacted creditors (after all, all allowed claims were paid in full plus 4% interest), but because of how they impacted a purported "class" of non-creditor donors. Respondents admit:

> As all of the lower courts observed, the class of claimants most directly impacted by the Challenged Provisions is comprised of those who made donations to NHF's [DAFs].

(Opp.22)

Echoing the Fourth Circuit, Respondents argue that the Plan fails three *Dow Corning* factors solely because of the Plan's alleged impact on donors: whether the impacted class overwhelmingly voted to accept the Plan (factor 4); whether the Plan provides a mechanism to pay all or substantially all of the class or classes affected by the injunction (factor 5); and whether the Plan provides an opportunity for those who choose not to settle to recover in full (factor 6).

Respondents disregard the reasons why donors are not a relevant "class." Under the Bankruptcy Code, in order to have a claim, one must have a "right to payment." 11 U.S.C. §101(5)(A). (App.172) Likewise, Section 1123(a)(1) requires that one must have a "claim" or "interest" in order to receive a distribution under a Plan. 11 U.S.C. §1123(a)(1). Respondents ignore these controlling statutes.

Respondents incorrectly assume, without explanation, that donors have "claims." (Opp.23) Their admissions show otherwise, as they acknowledge that "a DAF is a fund in which a donor relinquishes the right and title in the assets which are donated. . . ." (Opp.10) With no right or title, donors have no claim regarding donated assets.

Relying on *Stellwagen v. Clum,* 245 U.S. 605 (1918), and *Butner v. U.S.*, 440 U.S. 48 (1979), Respondents note that bankruptcy law looks to state law to define the contours of property rights and that different states may have different property laws.

(Opp.30) This is irrelevant, as no state property law is at issue. Rather, by operation of federal law, donors have *no* property right because they relinquished all right and title to funds they donated to a DAF. 26 U.S.C. §4966(d)(2)(A).

Respondents also ignore an independent reason why donors have no claim against NHF. Any claim donors might possibly have had has been either time-barred, disallowed, withdrawn or otherwise resolved. Of NHF's 9,000 donors, only approximately 200 filed claims. (RO¶16, App.71) Any possible claims of the vast majority, therefore, were time-barred. Of those that filed, all were disallowed prior to Plan confirmation based upon 26 U.S.C. §4966(d)(2)(A), except for the roughly dozen "Pending Donor Claims," where donors asserted that they had been fraudulently induced to donate. (RO¶22, App.73) The Behrmanns held such a Pending Donor Claim but settled and withdrew that claim. (RO¶29, App.74) All other Pending Donor Claims also were resolved. Thus, to now allow all donors, including those who formerly held Pending Donor Claims and those who did not, to sue NHF's directors and officers would give donors the "second and third bites at the apple" that the Bankruptcy Court believed would result in "an end run around the plan" that led it to conclude at the time of Plan Confirmation that the Releases were essential to NHF's reorganization.

B. The Decision Improperly Treats A Vote By Operation Of Law As If It Were Not A Vote.

Under NHF's Plan, Pending Donor Claims were classified in Class III(C). These were unimpaired because the Plan provided that any such claim that was ultimately allowed would be fully paid, along with 4% interest. (RO¶42, App.76-77) Because Class III(C) was unimpaired, Section 1126(f) "conclusively presumed" the class to have voted for the Plan. Respondents argue that this "stripped" class members of "any opportunity to vote upon the Reorganization of the Plan." (Opp.23) This is untrue – a vote by operation of law is still a vote. The Fourth Circuit held that despite Section 1126(f), NHF should have allowed class members to cast an actual ballot; but NHF had no authority to disregard what Section 1126(f) requires.[3]

C. The Decision Improperly Discounts NHF's Directors' And Officers' Contribution Of Continued Service.

While Respondents try to dispute this, the record shows that NHF's officers and directors planned to offer their continued service to NHF following its reorganization. The Plan specifically identifies each

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[3] And if holders of a Pending Donor Claim had wanted to cast an actual ballot, they could have so moved under Federal Rule of Bankruptcy Procedure 3018. None did.

officer by name and title and specifies the modest salary each would receive. (App.178-79) Janet Ridgely, NHF's corporate representative, testified that the officers and directors intended to serve the reorganized Debtor. Indeed, one reason why the Bankruptcy Court believed (erroneously) that the Releases were not essential is because it concluded that NHF's officers and directors would serve even absent the Releases.[4] (Opp.16)

Like the Fourth Circuit, Respondents interpret "substantial contribution" to mean a *financial* contribution. They ignore that where a Plan will pay all allowed claims in full, there is no financial contribution a director or officer could make. They disregard *In re Mercedes Homes*, 431 B.R. 809 (Bankr. S.D. Fla. 2009), where the one court that has addressed the substantial contribution factor in the context of a plan that pays claims in full held that continued service – "sweat equity" – is a sufficient contribution. Instead, like the Fourth Circuit, Respondents rely on *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), and *In re SL Liquidating, Inc.*, 428 B.R. 799 (Bankr. S.D. Ohio 2010), but in these cases creditors were not to be paid in full.

[4] Respondents note that Dr. John T. Houk left NHF after its reorganization (Opp.19), but omit that he did so because he retired at age 77, after serving NHF post-reorganization for one year.

D. The Decision Creates Insuperable Problems For Future Bankruptcies.

Respondents do not dispute that, if left to stand, the Fourth Circuit's Decision will create unmanageable difficulties for future proponents of Chapter 11 Plans that depend upon Nondebtor Releases in order to preserve a reorganized debtor as a going concern. Respondents do not explain what a Bankruptcy Court should do if Section 1126(f) "conclusively" deems a class to have voted for a Plan, but the class casts actual ballots to reject the Plan. Nor do they address how a Plan proponent should determine which non-creditor to allow to vote or how non-creditors should be classified. They do not explain how a court should rule if creditors vote to accept a Plan, but non-creditors vote to reject.

Respondents also ignore that the Decision will cause confusion in areas apart from Plan confirmation. Even though Congress in the Internal Revenue Code has stated that donors to a DAF relinquish all right, title and interest in donated assets, donors will rely on the Decision both in bankruptcy proceedings and in other litigation matters to assert ongoing legal rights in donated assets. This will plainly impact litigation involving the more than 1,000 DAFs administered by organizations in the United States. But donors to any charitable organization may also rely on the Decision to challenge how that organization uses donated funds, even where the law would otherwise deny them standing.

II. The Decision Disserves This Court's Mandate In *Bank Of America* To Preserve A Reorganized Debtor As A Going Concern.

A second ground for granting *certiorari* is that the Fourth Circuit's Decision gives short shrift to this Court's holding in *Bank of America* that the goal of a Chapter 11 bankruptcy is to preserve a going concern. 526 U.S. at 453.

The facts found by the Bankruptcy Court on remand demonstrate that if the Releases are unenforceable, NHF's ability to remain a going concern is imperiled. This risk stems from NHF's broad duty to indemnify and advance defense costs to its officers and directors when they are sued. Respondents acknowledge that "[t]here is an identity of interests between NHF and the released parties." (Opp.18) Respondents add:

> This factor is pertinent because, as the Sixth Circuit has observed, a suit against the nondebtor released party may, "in essence [be] a suit against the debtor" that risks "depleting the assets of the estate." *Dow Corning*, 280 F.3d at 658; *see also NHF I*, 663 F.3d at 711.

(Opp.18) In its petition, NHF noted that numerous courts have found that an identity created by an indemnification obligation was sufficient to justify a Nondebtor Release. *See* Pet. at 37-38 (quoting *A.H. Robins v. Piccinin*, 788 F.2d 994 (4th Cir. 1986); *Dow Corning*, 280 F.3d at 658; *In re Genco Shipping &*

Trading, Ltd., 513 B.R. 233 (Bankr. S.D.N.Y. 2014)). Respondents disregard this authority.

The Fourth Circuit found that NHF's indemnification obligation did not justify the Releases based on its erroneous conclusion the record lacked proof that donors would sue or that such suits would harm NHF.[5] In so concluding, the Fourth Circuit disregarded the facts found by the Bankruptcy Court. The Bankruptcy Court on remand found that "[t]he real possibility, indeed, the near certainty – of multiple donor suits, coupled with the officers' and directors' rights to indemnification and the advancement of legal expenses, could have a materially negative impact on the Debtor's ability to successfully complete its reorganization." (App.92-93) It made numerous other findings that confirm this, including:

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[5] Respondents emphasize that NHF elected not to reopen the record on remand in 2012. (Opp.16) This ignores that Respondents also sought to stand on the existing record and that the Fourth Circuit in *NHF I* never suggested that that record was inadequate, only that the requisite formal factual findings had not been made. This additionally ignores that the validity of the Plan's Releases was to be judged from the Bankruptcy Court's perspective at the time of confirmation in 2009. Respondents do not suggest how the record could have been reopened 2 1/2 years after Plan confirmation and long after the remainder of the Plan had been upheld in *NHF I* and substantially consummated. Regardless, the issue is a red herring because the factual findings made by the Bankruptcy Court based upon the existing record amply support the Releases.

- NHF was forced to seek bankruptcy protection after receiving an adverse $6 million judgment in a single donor suit (which was later found to be tainted by criminal bribery of the judge and guardian *ad litem*) (RO¶¶14-15, App.71);
- There are thousands of donors. If one could sue for possible recoveries, others also likely would (App.92-93);
- There were 343 claims filed against NHF totaling $51 million. Approximately 200 of these claims were filed by donors. (RO¶17, App.71)

Perhaps the clearest proof that donors will bring suits is shown by Respondents' own California Action. After settling and withdrawing their claims against NHF, they now have sued NHF's directors and officers (and NHF itself) for treble damages under RICO and other draconian relief based on the same allegations. They have tried to have a class certified and have received assignments from several other donors to also sue on their behalf. Unless enjoined, Respondents will certainly pursue such assignments from additional donors. The Fourth Circuit minimized the risk posed by Respondents' Action because it erroneously believed that it was being dismissed as to the directors and officers. (App.10n.5) Rather, that Action is pending and NHF already has spent more than $1,000,000 defending its directors and officers. While it disproves their argument that NHF's Releases are

not essential to its reorganization, Respondents never mention their California Action.

Like the Fourth Circuit, Respondents point to the Plan's severability clause to argue that the Releases are not essential because this clause provides that the Plan is enforceable even if an individual provision is found to be unenforceable. (App.182) This is illogical and incorrect. Respondents never address *Eckles v. Sharman*, 548 F.2d 905 (10th Cir. 1977) and other authority holding that the existence of a severability clause in a document does not mean that a given term is not "essential." Were it otherwise, no Nondebtor Release would ever be "essential" where a Plan has a severability clause (which is a common Plan term), because the clause's mere presence would make the Release non-essential. Indeed, under Respondents' logic, no Plan term would be essential where the Plan has a severability clause.

CONCLUSION

For these reasons and those set forth in NHF's petition, NHF respectfully requests that the petition for a writ of *certiorari* be granted.

December 9, 2014

Respectfully submitted,

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