Nos. 05-827, 05-941

In the Supreme Court of the United States

JAMES J. MCMONAGLE,
THE LEGAL REPRESENTATIVE FOR FUTURE CLAIMANTS,
Petitioner,

v.

CREDIT SUISSE FIRST BOSTON, AS AGENT, *ET AL.*,
Respondents.

OFFICIAL REPRESENTATIVES OF THE BONDHOLDERS AND
TRADE CREDITORS OF DEBTORS OWENS CORNING, *ET AL.*,
Petitioners,

v.

CREDIT SUISSE FIRST BOSTON, AS AGENT, *ET AL.*,
Respondents.

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

BRIEF FOR RESPONDENT CREDIT SUISSE FIRST BOSTON, AS AGENT, IN OPPOSITION

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QUESTION PRESENTED

Whether, under any valid application of the judicially developed bankruptcy doctrine of substantive consolidation, Owens Corning and seventeen of its subsidiaries that admitted having substantially correct financial statements showing each entity's assets and liabilities can propose a valid chapter 11 reorganization plan depriving their bank lenders of the subsidiaries' individual guarantees of $1.6 billion of bank loans, by "deeming," as to the banks only, that the subsidiaries would be merged into Owens Corning, thereby overriding the Bankruptcy Code to extinguish the guarantees and reducing the banks' aggregate bankruptcy principal distributions from $1.6 billion to $600 million.

PARTIES TO THE PROCEEDINGS AND RULE 29.6 STATEMENT

This matter arises out of a motion filed in bankruptcy court. The movants were petitioner James J. McMonagle; the Official Committee of Asbestos Claimants; and debtors Owens Corning *et al.*, more fully identified in 05-827 Pet. iii n.1. The motion was also supported by petitioners Official Representatives of the Bondholders and Trade Creditors of Debtors Owens Corning, the membership of which is identified in 05-941 Pet. ii and iii. The opponent of the motion was respondent Credit Suisse First Boston, as Agent for the prepetition bank lenders. Although the motion was filed in the first instance in the bankruptcy court, it was not decided in that court, but rather was decided in the first instance by the district court. *See* 05-827 Pet. App. 8 n.8. On appeal to the Third Circuit, the appellant was respondent Credit Suisse First Boston, as Agent for the prepetition bank lenders, and the appellees were the movants and motion supporters identified above. The listing of parties in 05-827 Pet. iii is accurate except to the extent it refers to appellees as "defendants/ appellees" and appellant as "plaintiff/appellant."

In this Court, McMonagle and the Official Representatives of the Bondholders and Trade Creditors of Debtors Owens Corning are petitioners; the Official Committee of Asbestos Claimants is a respondent under Rule 12.6 and has filed a brief in this Court as a respondent supporting petitioners; and debtors Owens Corning *et al.* are respondents under Rule 12.6.

Respondent is Credit Suisse, Cayman Islands Branch, formerly known as Credit Suisse First Boston. It is a branch of Credit Suisse, which is a wholly owned subsidiary of Credit Suisse Group, the shares of which are publicly traded on the Swiss Stock Exchange. No publicly held corporation owns 10% or more of the stock of Credit Suisse Group.

Credit Suisse, Cayman Islands Branch, is Agent for a syndicate of lenders to Owens Corning. The current members of that syndicate include Bear Stearns & Co. Inc. and UBS AG, both of which have issued publicly traded common stock. The

current members of the lending syndicate also include Credit Suisse, Cayman Islands Branch, Bank of America, N.A., Citibank, N.A., Citigroup Financial Products, Inc., Deutsche Bankers Trust Co., Goldman Sachs Credit Partners, L.P., JP Morgan Chase Bank, Lehman Commercial Paper, Merrill Lynch Credit Products, and Morgan Stanley Emerging Markets, whose parent entities have issued publicly traded common stock. Those parent entities are Credit Suisse Group, Bank of America Corp., Citigroup, Inc., Deutsche Bank Group, Goldman Sachs Group, Inc., JPMorgan Chase & Co., Lehman Brothers, Inc., Merrill Lynch & Co., Inc., and Morgan Stanley, respectively. Credit Suisse, Cayman Islands Branch, is not aware of any other current members of the lending syndicate that have issued, or are subsidiaries of entities that have issued, publicly traded equity and does not maintain or have ready access to such information.

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BRIEF FOR RESPONDENT CREDIT SUISSE FIRST BOSTON, AS AGENT, IN OPPOSITION

Nonconsensual substantive consolidation is an extraordinary remedy, devised by judges – despite the absence of any specific statutory authorization for disregard of the corporate form in this manner – to deal with extreme situations in bankruptcy cases. Rather than compute how much each debtor-entity owes each of its creditors, the remedy treats separate corporations as if they were merged, thereby treating all creditors as if they were creditors of one combined entity. Here, Owens Corning attempted to radicalize this extraordinary remedy in three respects. First, it requested substantive consolidation only on a "deemed" (make-believe) basis, thereby leaving the corporate structure unchanged after bankruptcy while computing distributions to Owens Corning's bank lenders as if the subsidiaries had been merged into Owens Corning so the banks would lose the benefits of the guarantees they received from twelve of the subsidiaries. Second, Owens Corning specified this make-believe substantive consolidation would be used only to compute (and thereby diminish) the banks' distributions and not to compute any other creditor's distribution from any of the subsidiaries. Third, Owens Corning requested this relief while admitting its financial statements substantially correctly specified that each entity's assets and liabilities and that the banks required the guarantees when they committed to making the loan.

No decision from any court of appeals has ever granted such radical relief in similar circumstances. Moreover, no decision of any court of appeals has ever granted a less radicalized substantive consolidation when its proponents admitted that each entity's assets and liabilities were known and the objecting creditor had shown its recognition of separate entities by requiring separate guarantees. This case provided the Third Circuit an opportunity to state comprehensively its view of the substantive consolidation doctrine, including its view of the

hazards of following or misconstruing stray language in opinions of other courts. *See* 05-827 Pet. App. 23-27. To reject Owens Corning's proposed substantive consolidation, however, the court did not need to place itself in conflict with any other court besides the district court it was reversing. Rather, as bankruptcy professors Robert K. Rasmussen, Barry Adler, Susan Block-Lieb, G. Marcus Cole, Marcel Kahan, Ronald J. Mann, and David A. Skeel, Jr., advised the Third Circuit in an amicus brief filed December 29, 2004 (at 1), "no appellate court to date has confronted a situation similar to the one presented in this case." *See also* 05-827 Pet. App. 24-25 & n.17 (agreeing with other aspects of professors' brief).

Significantly, every court of appeals cites with approval the decisions from the Second Circuit ruling that substantive consolidation is granted sparingly and only where necessary to remedy harm caused by fraud, hopeless commingling of assets, or an expectation by all creditors that they were dealing with one entity. None of those factors exists here. Some courts of appeals are more specific than others as to exactly which harms or benefits justify substantive consolidation. But the case at bar is not on the fringes. It comes nowhere close to satisfying any circuit's requirements.

There is no conflict among the courts of appeals with respect to the "easy" issue decided by the Third Circuit. 05-827 Pet. App. 2. Finally, petitioners' assertion that the Third Circuit inappropriately disregarded the district court's findings of fact is untrue. The district court wrote a seven-page decision of which a few scattered sentences purport to sum up more than 10,000 pages of trial record. As the Third Circuit showed, the district court simply did not account for the undisputed individual facts relating to the different subsidiaries.

STATEMENT

A. Relevant Facts

1. Owens Corning's Operations and Corporate Structure. Owens Corning is a Fortune 200 multinational company with an elaborate and carefully maintained corporate structure. Each

subsidiary of Owens Corning, the parent Delaware corporation ("OCD") was a separate legal entity that scrupulously observed corporate formalities[1] and had a legitimate reason to exist separately. The subsidiaries were formed for a variety of business and strategic objectives. Some subsidiaries were free-standing, operational companies in their own right; some subsidiaries were formed to limit asbestos-related liability concerns; some were formed to gain tax and other business benefits; and others were formed for regulatory reasons. The financial affairs of each subsidiary were properly documented.[2] Each subsidiary maintained its own business records, and intercompany transactions were regularly documented. While OCD, as the parent corporation, owns all the stock of its subsidiaries and operated its enterprise in an integrated manner, the legal structure of its subsidiary corporations was respected at all times.

Examples of the major subsidiaries are as follows: Integrex was a freestanding entrepreneurial company designed to market litigation management, materials testing, and other services to third parties. CA App. 601-02, 760, 824-28, 831-32, 5421, 5423, 5426, 5427, 5438, 5821, 7813; CA Conf. App. 898: 109a, 239, 239a, 245, 266, 308, 356, 357a, 358, 367-68, 370-71, 380, 413, 426, 430a, 448-57j. Exterior Systems, Inc. ("Exterior") was formed after several subsidiaries of Fibreboard Corporation

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[1] *See, e.g.*, CA Conf. App. 983: 33, 37-38, 39, 41-42, 47-48, 108, 310-11, 316-18, 355-58; CA Conf. App. 1022: 8, 8a, 8b, 9, 10, 13-14, 19-20, 26, 32-46, 50-61, 339; CA Conf. App. 898: 1, 1K, 2, 3, 6-10, 20-22, 151, 156, 158, 554, 655, 660, 661, 663-64; CA Conf. App. 830: 5-20, 199-02, 208-12, 225-32, 233, 234, 235-42, 243-45, 250-52, 253-55, 257, 258, 259-60, 261, 263-69, 271-73, 276-85, 286-95, 299, 300-05, 306-08, 311-15, 318, 320-23, 324, 327, 339-54, 355-58, 361.

[2] CA App. 465-67, 692-93, 1303-04, 2954, 2958, 3002, 3004, 3006, 3008, 3010, 3012, 3018, 3029, 3262, 3652, 4579, 5162, 5200, 5310, 6391, 6499, 6612, 6760, 7057, 7126.1, 7823, 7862, 7951, 7959, 8365, 8429, 8523, 8927-37, 9111-13, 9346-50, 9666-9738, 9744, 9953-54, 9959-59.1, 9975-76, 9978, 9979, 10087, 10090-91; CA Conf. App. 898: 137, 139-40, 144-45, 174-75, 330, 541-42, 544; CA Conf. App. 1022: 296, 304-312, 328; CA Conf. App. 983: 52, 81-84, 268, 339-41; CA Conf. App. 830: 363, 379, 395, 412, 427, 434, 437.

("Fibreboard") merged into OCD to hold the operating assets of the Fibreboard subsidiaries. CA Conf. App. 831, 868-69, 889; CA Conf. App. 1 at OC001 000528. It owned more than $1 billion in property, including 20 factories and 150 to 180 distribution centers. CA App. 586, 2990, 2994, 9900. IPM, Inc. ("IPM") was formed to consolidate the investments of OCD's foreign subsidiaries and to isolate valuable foreign subsidiaries from OCD's asbestos liability while protecting OCD from the liabilities of those subsidiaries. CA App. 3261. Owens-Corning Fiberglas Technology, Inc. ("OCFT") was created as an intellectual property holding company, which licensed its property back to OCD in return for royalty payments. CA App. 5829, 7254; CA Conf. App. 983: 33(a). Exterior, OCFT, and IPM each performed their own accounting and maintained separate financial books and records.[3] Furthermore, there is no confusion or dispute as to the principal assets of each of these entities: (i) Integrex – two $501 million debentures issued by IPM and OCFT; (ii) Exterior – substantial operating assets; (iii) OCFT – valuable domestic intellectual property; and (iv) IPM – stock of foreign operating subsidiaries. CA Conf. App. 983:77; CA Conf. App. 1022: 170-94; CA App. 327, 850-51.

2. The Credit Agreement and Guarantees. In 1997, twelve subsidiaries of OCD issued guarantees to the prepetition bank lenders (the "Banks") to support a $2 billion extension of unsecured credit to OCD. No lender was willing to extend $2 billion in unsecured credit to OCD without an alternative source of repayment on default in light of the fact that OCD was facing continuing asbestos liability and about to acquire Fibreboard entirely with debt. Accordingly, Credit Suisse First Boston, as Agent for the Banks (the "Agent"), proposed to grant the credit only if each subsidiary guaranteed it, giving the Banks direct claims against the guarantors.

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[3] *See, e.g.*, CA App. 692-93, 3262, 3652, 4579, 5162, 5200, 5310, 6391, 6499, 6612, 6760, 7057, 7126.1, 9744, 9953-54, 9959-59.1, 9975-76, 9978-79, 10087, 10090-91; CA Conf. App. 898: 330, 541-42, 544.

Several draft loan term sheets were prepared, each of which included subsidiary guarantees. The final term sheet required OCD to provide guarantees from Fibreboard as well as all material domestic subsidiaries. In drafting the credit agreement, the Banks focused on the characteristics of the "material domestic subsidiaries," and the parties agreed to OCD's proposal that the Banks would obtain a guarantee from each entity having assets with aggregate book value of at least $30 million. The terms of the loan were set out in the credit agreement dated June 26, 1997 (the "Credit Agreement"). CA Conf. App. 1.

The Banks had a great deal of information regarding the value and debts of the guarantor subsidiaries. *See* 05-827 Pet. App. 30. For example, they knew that (i) the assets of the seven non-Fibreboard subsidiary guarantors alone were worth at least $210 million in aggregate book value of assets; (ii) OCFT and IPM each had value far in excess of $30 million; (iii) five of the seven non-Fibreboard subsidiary guarantors, including OCFT and IPM, had no debt at all, and the debt of the remaining two was de minimis, as indicated on the debt schedule the Banks insisted OCD attach to the Credit Agreement; and (iv) the value of the Fibreboard subsidiary guarantors' businesses was approximately $700 million based on specific financial information provided in connection with the Fibreboard acquisition, and these corporations would be debt-free postacquisition. CA App. 977, 1009-11, 1012-13, 1015-18, 1713, 1831, 1896-97, 2180, 2224-25, 2286, 3237, 10005-07, 10011-16; CA Conf. App. 1, Schedule 5.01(b)(i). Thus, when the Banks extended credit under the Credit Agreement, they knew they were receiving guarantees from twelve subsidiaries with an aggregate value exceeding $900 million and no material debt.

Because the Banks were extending credit to a company with a shaky credit rating facing substantial asbestos liability, the Banks insisted on subsidiary guarantees as a necessary "credit enhancement." The guarantees were the *sine qua non* of the unsecured loan to OCD – they gave the Banks direct claims against the guarantor subsidiaries if OCD defaulted, independent of the claims against OCD as parent/borrower, placing the

Banks in a structurally senior position to other unsecured creditors of OCD who did not bargain for that protection.

The terms of the Credit Agreement further underscore the Banks' reliance on, and desire to protect, the guarantees. For example, the Credit Agreement made it extremely difficult for a guarantor to secure a release from its obligations. A guarantee could be released only with the consent of the Banks holding fifty-one percent of the debt, and with respect to the Fibreboard subsidiary guarantees only with unanimous consent of the Banks. CA Conf. App. 1, § 13.05; CA App. 5704. The only exception was for guarantor subsidiaries disposed of for fair value in a permitted transaction under Section 8.10 of the Credit Agreement, which limited such transactions to assets with a cumulative value of less than ten percent of the assets of the consolidated company. CA Conf. App. 1, §§ 8.10, 13.05.

The Credit Agreement also precludes certain mergers involving the guarantor subsidiaries. The first portion of Section 8.09 of the Credit Agreement prohibits the merger of a guarantor subsidiary into the parent company. The latter portion of Section 8.09 prohibits mergers between subsidiaries except those that would have no impact on the value of the guarantees: (i) the merger of a nonguarantor with and into any one or more other Subsidiaries; and (ii) the merger of one guarantor subsidiary with another guarantor subsidiary. CA App. 1448-49. The Banks had insisted on this additional prohibition because they wanted to have certain restrictions on subsidiaries merging to protect their interest in the guarantees. CA App. 1415-16.

3. No Commingling of Assets or Other Financial Entanglement. The record reflects no commingling of assets or other financial entanglement between OCD and its principal subsidiaries. All intercompany transactions involving OCFT, IPM, Integrex, and Exterior were recorded by legal entity in OCD's global SAP accounting system. CA App. 1569-72. Because OCFT, IPM, and Exterior performed their own accounting and maintained separate financial books and records, the accuracy of the information is independently verifiable from the subsidiaries' own records. CA App. 1659-60. Moreover, after

commencing its chapter 11 case, OCD, with the assistance of Ernst & Young, spent $6 million on an "intercompany finance project" to get intercompany accounts at a level of quality it believed to be a fair representation of the books of the individual legal entities. CA App. 465-67. This project enabled each Debtor separately to file its own financial statements with the bankruptcy court. Two OCD officers testified that the financial statements of all the subsidiaries were accurate in all material respects. CA App. 465-67, 571-73, 1645-46, 1656-57, 3018, 3029, 7823, 7862, 7951, 7959, 8365, 8429.

B. Proceedings Below

1. On October 5, 2000, each of the Debtors commenced a voluntary case under chapter 11, title 11, United States Code (the "Bankruptcy Code") to address the asbestos liability of OCD and Fibreboard. In October 2002, the Debtors commenced an adversary proceeding seeking to avoid the Banks' guarantees as fraudulent conveyances. The district court withdrew the reference to the bankruptcy court of this action. The Banks' motion to dismiss the action is still pending.

On January 17, 2003, the Debtors, the Legal Representative for Future Claimants (the "Futures Representative" or "FR"), and the Official Committee of Asbestos Claimants (the "ACC"), as co-sponsors (collectively, the "Plan Proponents"), filed with the bankruptcy court a joint plan of reorganization (the "Plan"), predicated on the Debtors' obtaining a "deemed" substantive consolidation against the Banks only and treating the Banks as if they had no guarantees. That same day, the Debtors filed a motion for substantive consolidation, which consumed thirteen trial days before District Judge Wolin in April and May 2003. After trial, but before decision, Judge Wolin was replaced by District Judge Fullam. 05-827 Pet. App. 70-71.

In a very short opinion, Judge Fullam approved Owens Corning's "deemed" substantive consolidation. 05-827 Pet. App. 46-54. He ruled that there is a "substantial identity" among OCD and its subsidiaries, substantive consolidation would "greatly simplify and expedite" the successful completion of the chapter 11 cases, and it would be "exceedingly diffi-

cult" to untangle the financial affairs of the various entities. *Id.* at 50-52. The district court also ruled the Banks relied on the overall credit of the entire enterprise and there was "no basis for a finding that, in extending credit, the banks relied upon the separate credit of any of the subsidiary guarantors." *Id.* at 51. Simply overlooking a wealth of record evidence, see p. 5, *supra*, Judge Fullam said it was "important to note that * * * the Banks had no information about the debts of [the] subsidiaries." *Id.*

2. A unanimous panel of the Third Circuit reversed in an opinion by the court's leading bankruptcy expert, Judge Ambro. 05-827 Pet. App. 1-36. The Third Circuit recognized that, given the facts before it, the outcome is "easy" even though the area of law is difficult. *Id.* at 2. The district court "did not make factual determinations necessary even to consider" use of the substantive consolidation power in bankruptcy. *Id.* The Third Circuit found no reason to undo OCD's and the Banks' arm's-length negotiation for subsidiary guarantees of loans to OCD in exchange for a $2 billion unsecured loan to OCD. *Id.* at 36. The Third Circuit reasoned that overturning this bargain, set in place by OCD's own preloan choices of organizational form, would cause chaos in the marketplace. *Id.*

The Third Circuit surveyed the history of substantive consolidation. As a general principle, it observed, corporate disregard as a fault may lead to corporate disregard as a remedy. 05-827 Pet. App. 15. The court traced the development of the doctrine since *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215 (1941), noting that several Second Circuit decisions form the basis of today's understanding of the law and that "other Circuit Courts fell in line in acknowledging substantive consolidation as a possible remedy." 05-827 Pet. App. 18.

The Third Circuit observed that there is consensus that substantive consolidation is an equitable remedy to be used "sparingly." 05-827 Pet. App. 22. The court went on to state that it essentially favored the analysis in *Union Savings Bank v. Augie/Restivo Baking Co. (In re Augie/Restivo Baking Co.)*, 860 F.2d 515 (2d Cir. 1988). 05-827 Pet. App. 23.

The Third Circuit then set forth the underlying principles of substantive consolidation: (i) Limiting the cross-creep of liability by respecting entity separateness is fundamental, and the general expectation of state law, the Bankruptcy Code, and commercial markets is that courts respect entity separateness in the absence of compelling circumstances calling equity into play; (ii) the harms substantive consolidation addresses are nearly always those caused by debtors who disregard separateness, while harms caused by creditors are remedied by provisions in the Bankruptcy Code (e.g., 11 U.S.C. §§ 544(b)(1), 548 (fraudulent transfers); *id*. § 510(c) (equitable subordination); (iii) mere benefit to the administration of the case does not justify substantive consolidation; (iv) because substantive consolidation is extreme and imprecise, this "rough justice" remedy should be rare and one of last resort after considering and rejecting more precise remedies conferred by the Bankruptcy Code; and (v) while substantive consolidation may be used defensively to remedy identifiable harms caused by entangled affairs, it may not be used offensively (e.g., having a primary purpose of disadvantaging tactically a group of creditors in the plan process or altering creditor rights). 05-827 Pet. App. 25-26.

The Third Circuit held that what must be proven concerning the entities for which nonconsensual substantive consolidation is sought is that (i) prepetition they disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity; or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors. 05-827 Pet. App. 26.

A prima facie case for the first factor exists when, based on the parties' prepetition dealings, a proponent of substantive consolidation proves corporate disregard creating contractual expectations of creditors that they were dealing with debtors as one indistinguishable entity. 05-827 Pet. App. 27. Proponents who are creditors must also show that, in their prepetition dealings, they actually and reasonably relied on the debtors' supposed unity. *Id.* Creditor opponents can defeat such a showing

if they prove they are adversely affected by substantive consolidation and actually relied on the debtors' separate existence. *Id.*

Under those principles, "the outcome of this appeal is apparent at the outset." 05-827 Pet. App. 28. In lending $2 billion to OCD in an unsecured loan with subsidiary guarantees, through "the 'deal world' equivalent of 'Lending 101,'" the Banks got "structural seniority" – a direct claim against the subsidiary-guarantors that other creditors of OCD did not have. *Id.* "This kind of lending occurs every business day. To undo this bargain is a demanding task." *Id.*

The Third Circuit relied on many undisputed record facts. There was no prepetition disregard of corporate separateness. 05-827 Pet. App. 28. Negotiation of the Credit Agreement was "premised on the separateness of all OCD affiliates." *Id.* No allegation of bad faith exists concerning the loan. *Id.* Obtaining the guarantees of separate entities, made separate by OCD's choice of how to structure the affairs of its affiliates, entitles a lender to look to any or all guarantors for payment. *Id.* at 29.

Next, the Third Circuit observed from OCD's own admissions, 05-827 Pet. App. 3-5, that no hopeless commingling exists postpetition. *Id.* at 31.[4] The Plan Proponents did not even "fulfill their burden of demonstrating that Debtors' affairs are tangled, let alone that the cost of untangling them is so high relative to their assets that the Banks, among other creditors, would benefit from a consolidation." *Id.* at 34.

The Third Circuit described other considerations that "doom[ed]" substantive consolidation. 05-827 Pet. App. 34-35. Among other things, substantive consolidation should be used defensively to remedy identifiable harms, not offensively to achieve advantage over one group in the plan negotiation process, and certainly not as a "free pass" to spare the Debtors or other parties from proving the guarantees were voidable as fraudulent transfers. Finally, the Third Circuit noted with

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[4] "Hopeless commingling" refers to the situation, likely to arise only in relatively small cases, in which it would cost so much to sort out assets that *all* creditors will be worse off. 05-827 Pet. App. 26 & n.20.

disapproval that the consolidation sought was "deemed," or a pretend consolidation for all except the Banks. *Id.* at 35. If the Debtors' corporate and financial structure was such a sham before the filing of the substantive consolidation motion, the Third Circuit questioned, how is it that this structure stays undisturbed after the Plan becomes effective, with the Debtors reaping all the liability-limiting, tax, and regulatory benefits achieved by forming subsidiaries in the first place? *Id.* "[T]he Plan Proponents seek to remake substantive consolidation not as a remedy, but a stratagem to * * * strip the Banks of rights under the Bankruptcy Code, favor other creditors, and * * * trump possible objections to the Plan by the Banks." *Id.*

The Futures Representative and the self-styled Official Representatives of the Bondholders and Trade Creditors of Debtors Owens Corning (the "Bondholders") sought rehearing en banc. Despite having sought substantive consolidation, the Debtors did not seek rehearing. Rather Owens Corning's general counsel immediately stated publicly that the decision would facilitate its reorganization. *See* Gary T. Pakulski, *Key bankruptcy provision upset*, TOLEDO BLADE, Aug. 16, 2005 (quoting OCD General Counsel Stephen Krull: "'We simply are happy to have this issue decided. … The certainty, we believe, will pave the way for us to have productive discussions with our creditors and move our case forward.'"). Rehearing en banc was denied without recorded dissent. 05-827 Pet. App. 68.

REASONS FOR DENYING THE PETITION

The decision below is correct and does not conflict with any decision of this Court or any other court of appeals. This case provided a circuit in which many companies are incorporated with a chance, on a fully developed record, to provide needed guidance about how to apply the judge-made doctrine of substantive consolidation. The Third Circuit's scholarly opinion, written by the court's leading bankruptcy expert and in line with the views of all the bankruptcy scholars who participated in the briefing below, valuably contributes to the decisional law on this topic.

The court's salutary law-clarifying discussion, however, should not be confused with its case-dispositive holdings. As the Third Circuit stated, "[w]hile this area of law is difficult * * *, its outcome is easy with the facts before us." 05-827 Pet. App. 2. Petitioners' argument – aptly recognized as "a ploy to deprive one group of creditors of their rights while providing a windfall to other creditors" (*id*. at 3) – was rightly rejected on many grounds. Even if this Court might someday have occasion to clarify the extra-statutory substantive consolidation doctrine (in the unlikely event other courts reject the Third Circuit's views), this case is one in which under no "test" could this Court ultimately agree with petitioners that grounds for disregard of corporate separateness exist. Under no decision from any circuit should the Banks' contractual rights to structural seniority be disregarded, and a billion dollars transferred to other creditors, by pretending that the entities from which the Banks obtained bargained-for guarantees do not exist.

I. THERE IS NO CONFLICT IN THE CIRCUITS

1. The decision below does not conflict with the decision of any other court of appeals. No other court of appeals has confronted a similar case and granted substantive consolidation. The leading cases from the D.C. and Second Circuits, like the decision below, both *reversed* orders of consolidation. They are strange candidates for an assertion of circuit conflict, and the assertion falls apart on examination.

Petitioners claim the Third Circuit's decision conflicts with two similar approaches. Under the first approach, set forth in dictum in *Drabkin v. Midland-Ross Corp. (In re Auto-Train Corp.)*, 810 F.2d 270, 276 (D.C. Cir. 1987), and followed by the Eighth and Eleventh Circuits, the bankruptcy court may order substantive consolidation upon a showing that there was substantial identity between the entities to be consolidated and that the benefits of substantive consolidation are necessary to avoid some harm or realize some benefit, unless the opponents of consolidation show they relied on the separate credit of one of the entities. If the opponents of consolidation make such a showing, then the court should not order substantive consolida-

tion unless the benefits of substantive consolidation would "heavily" outweigh the harms. *Id.* The second approach, established by the Second Circuit in *Union Savings Bank v. Augie/Restivo Baking Co. (In re Augie/Restivo Baking Co.)*, 860 F.2d 515 (2d Cir. 1988), and followed by the Ninth Circuit, focuses on whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit, or whether the affairs of the debtor are so entangled that consolidation will benefit all creditors.[5]

As a threshold matter, petitioners' claim that the D.C. Circuit and the Second Circuit apply meaningfully different standards is fully rebutted by reference to *Auto-Train*, 810 F.2d at 276, which bases its articulation of substantive consolidation standards on decisions from the Second Circuit. Additionally, petitioners' claim of a conflict between the Third Circuit, on the one hand, and the D.C. and Second Circuits, on the other, is rebutted by the Third Circuit's embrace (05-827 Pet. App. 23) of the Second Circuit's substantive consolidation standards.

For purposes of certiorari decisions, a "genuine conflict, as opposed to a mere conflict in principle, arises when it may be said with confidence that two courts have decided the same legal issue in opposite ways, based on their holdings in different cases with very similar facts." R. STERN ET AL., SUPREME COURT PRACTICE 226 (8th ed. 2002). Petitioners assert a genuine conflict exists. Yet they have not cited any decision in which a court of appeals has confronted a situation similar to the one presented in this case and concluded that substantive consolidation was appropriate. Contrary to the Bondholders' assertions, there are no real differences in analysis that would lead to disparate results among the courts of appeals, especially not on the facts of this case. Substantive consolidation simply is not

[5] As one commentator has observed, "*Auto-Train* discusses substantive consolidation only in dictum and purports to follow the cases in the Second Circuit. Nevertheless, other courts have managed to tease out of it a test for substantive consolidation that is distinctly different from that of the Second Circuit and is far less demanding." Douglas G. Baird, *The Future of Chapter 11*, 47 BOSTON COLLEGE L. REV. 5, 8 n.7 (2005).

warranted in these chapter 11 cases under any court's formulation of the governing doctrine. "Quite apart from which test was being used * * *, the outcome in *In re Owens Corning* was almost foreordained." Baird, *supra* note 5, at 14.

The decision below is directly in line with – not in conflict with – the Second Circuit's decision in *Augie/Restivo*. In *Augie/Restivo*, the court reversed an order granting substantive consolidation. The bank proponent of substantive consolidation had lent money during the bankruptcy to the parent corporation and received a superpriority claim. By consolidating the parent with the subsidiary, the bank would have obtained a superpriority claim to the subsidiary's assets and thereby disadvantaged the bank creditor of the subsidiary. The latter bank had lent money to the subsidiary before bankruptcy and before there was any connection between the parent and subsidiary. Substantive consolidation was as unwarranted there as it would be here. The Second Circuit disapproved substantive consolidation because it would impair the rights of the subsidiary's bank creditor, Union Savings Bank, which extended credit to Augie's Baking Company before its stock was acquired by Restivo Brothers Bakers and would unfairly benefit later creditors of the parent who were aware of the debtors' separateness.

The Second Circuit stated the "sole purpose of substantive consolidation is to ensure the equitable treatment of all creditors" and examined the "numerous considerations" mentioned in prior decisions: "An examination of those cases * * * reveals that these considerations are mere variants on two critical factors: (i) whether creditors dealt with the entities as a single economic unit and 'did not rely on their separate identity in extending credit,' * * * or (ii) whether the affairs of the debtor are so entangled that consolidation will benefit all creditors." 860 F.2d at 518 (quoting 5 COLLIER ON BANKRUPTCY § 1100.06, at 1100-33). In articulating this test, the Second Circuit simply used a shorthand method of summarizing the considerations used in earlier decisions. Contrary to petitioners' assertions, the Second Circuit and the Third Circuit are in agreement about the

test to be applied.[6] And, contrary to the assertions of the Bondholders (05-941 Pet. 11), a balancing of the parties' interests is used by both circuits, but only after the rigorous requirements for substantive consolidation are satisfied.[7]

On the facts of *Augie/Restivo*, the Second Circuit thought it fatal to substantive consolidation that the bank relied on the debtors' "separate identity when extending credit." 860 F.2d at 518. Similarly, the Third Circuit realized the obvious: the Banks relied on the existence of separate subsidiaries by negotiating for guarantees from such subsidiaries. Consistent with *Augie/Restivo*, the Third Circuit agreed the reliance inquiry is not an inquiry into lenders' internal credit metrics. Rather, it is about the fact that the credit decision was made in reliance on the existence of separate entities. 05-827 Pet. App. 31.

Petitioner FR asserts that a conflict exists because the second prong of the Third Circuit's test makes substantive consolidation extremely difficult by requiring that "every creditor" must benefit from the consolidation. 05-827 Pet. 19. This is no different, however, from the test formulated in *Augie/Restivo*, where the Second Circuit stated that the second alternative basis for considering substantive consolidation is "whether the affairs of the debtors are so entangled that consolidation will benefit *all creditors*." 860 F.2d at 518 (emphasis added). The rationale is the same – substantive consolidation should be used only if all creditors will benefit because untangling is either impossible or so costly as to consume the assets. *Id.* at 519.

Petitioners also argue the Second and Third Circuits are in conflict because the Second Circuit's test does not address

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[6] The Bondholders' assertion that the first factor in *Augie/Restivo* requires "only that creditors 'dealt with' the affiliated entities as a single unit" (05-941 Pet. 12) is misleading. It omits the portion that also requires a demonstration that other creditors did not rely on the entities' separate identity in extending credit. 860 F.2d at 518.

[7] The Ninth Circuit, which follows *Augie/Restivo*, recognized that, in ordering substantive consolidation, courts must "balance the benefits that substantive consolidation would bring against the harms that it would cause." *In re Bonham*, 229 F.3d 750, 765 (9th Cir. 2000).

burden of proof, while the Third Circuit "places all burdens on the proponents of substantive consolidation." 05-827 Pet. 12; *see also* 05-941 Pet. 12 n.6. This "easy" case (05-827 Pet. App. 2), however, is not one in which the proof was in equipoise on any critical factual question so that the burden of proof mattered. Furthermore, the Third Circuit did not place all burdens on the proponent. It ruled proponents of substantive consolidation have the burden of showing one of two rationales for consolidation. Once a proponent of consolidation establishes a prima facie case that the entities disregarded separateness so significantly that their creditors relied on the breakdown of entity borders, consolidation opponents have the burden of proving they are adversely affected and actually relied on the debtors' separate existence. 05-827 Pet. App. 27.

The decision below also does not conflict with the D.C. Circuit's decision in *Auto-Train*, which was adopted by the Eleventh Circuit in *Eastgroup Properties v. Southern Motel Assoc*., 935 F.2d 245 (11th Cir. 1991). Petitioner FR takes it as a given that the *Auto-Train* test would lead to a grant of substantive consolidation on the facts of this case. Indeed, it goes so far as to assert in the text of the second question presented that the "facts satisfied the standard utilized by several other courts of appeals." 05-827 Pet. i. And the Bondholders argue that, if the Debtors' cases had been filed in a circuit that followed *Auto-Train*, the result would have been different. 05-941 Pet. 17. Those assertions are mere wishful thinking. The facts of the present case do not satisfy *Auto-Train*'s articulation of the Second Circuit's substantive consolidation standard, a standard that both the D.C. Circuit and the Third Circuit below have cited with approval. As the bankruptcy professor amici said in their amicus brief below (at 4), "a sensible application of any of these tests and factors reveals the district court's decision to order substantive consolidation here to be in error."

In *Auto-Train*, the grant of substantive consolidation between Auto-Train and its nonbankrupt subsidiary, Railway, had already occurred and was not contested on appeal. 810 F.2d at 276. The sole issue was whether the consolidation should be

made retroactive (nunc pro tunc) so Railway could sue a vendor to recover a preferential payment that occurred within ninety days of Auto-Train's bankruptcy, but not within ninety days before Railway had been consolidated with Auto-Train. *Id.* at 273. The D.C. Circuit reversed the grant of retroactive consolidation because of the "vendor's reliance on the separate credit" of Railway, even though Railway was the alter ego and instrumentality of Auto-Train. *Id.* at 277.

The Bondholders speculate that the D.C. Circuit would have reached a different result in this case because the district court found that substantive consolidation would simplify and expedite the successful completion of the Debtors' chapter 11 cases. 05-941 Pet. 16. But all the clues in the D.C. Circuit's opinion as to what it would have done on such facts – which were not before it – are to the contrary. The D.C. Circuit protected the interests of the entity that relied (as the Banks did here) on the separateness of Auto-Train and Railway. If simplification and expedition would have convinced the D.C. Circuit to uphold retroactive substantive consolidation, one would think the enlargement of the bankruptcy estate with a preference recovery would similarly have convinced the D.C. Circuit, but the court decided exactly the opposite. The Third Circuit's decision is not in conflict with *Auto-Train* and its progeny.[8]

There is also no conflict with the Eleventh Circuit, which adopted *Auto-Train* in *Eastgroup Properties v. Southern Motel Assoc.*, 935 F.2d 245 (11th Cir. 1991). The facts in *Eastgroup* are totally dissimilar to the present case, and there is no "virtual certainty" the Eleventh Circuit's decision would have been different under the Third Circuit's analysis. 05-941 Pet. 21. *Eastgroup* involved two commonly owned real estate partnerships in chapter 7 liquidation cases (as opposed to the chapter 11 reorganization case here). SMA owned and leased motel properties, and GPH leased or subleased the motels from SMA and operated them. The Eleventh Circuit granted substantive consolida-

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[8] *See* Baird, *supra* note 5, at 10 ("The *Auto-Train* test has morphed into long laundry lists.").

tion based on (i) a debtor's inducement to a creditor to perform services by falsely representing which debtor owned the motel the creditor was repairing (no misrepresentations exist here); (ii) the indiscriminate payment by one debtor of the other's debts (here, there was a well-managed cash management system under which each entity's obligations and payments were recorded and managed lawfully); and (iii) the need to provide one debtor's estate with additional funds for administrative expenses, on a record reflecting significant financial entanglement and disregard of corporate separateness. 935 F.2d at 250-53.

The Third Circuit took no exception to the result in *Eastgroup*. Rather, it noted (05-827 Pet. App. 22 n.15) that it does not subscribe to the "liberal trend" mentioned in some bankruptcy court decisions cited in *Eastgroup*. After *Eastgroup*, the Eleventh Circuit denied substantive consolidation in *Reider v. FDIC (In re Reider)*, 31 F.3d 1102 (11th Cir. 1994), following conventional principles emanating from the Second Circuit. *E.g.*, *id*. at 1109 (citing statements from *Chem. Bank N.Y. Trust Co. v. Kheel (In re Seatrade Corp.)*, 369 F.2d 845, 847 (2d Cir.1966), and *In re Flora Mir Candy Corp*., 432 F.2d 1060, 1062 (2d Cir.1970), about the need for caution in allowing substantive consolidation).

The Third Circuit's decision also does not conflict with the Eighth and Ninth Circuits. In *First National Bank of El Dorado v. Giller (In re Giller)*, 962 F.2d 796, 798 (8th Cir. 1992), the court approved substantive consolidation where the sole shareholder of six corporations had "abused the [d]ebtors' corporate forms" and such abuse harmed the creditors of many of the corporations. The court granted substantive consolidation in *In re Bonham*, 229 F.3d 750 (9th Cir. 2000), because an individual used interrelated shell corporations to effect a Ponzi scheme. The Third Circuit would have allowed substantive consolidation in each case because "[c]orporate disregard as a fault may lead to corporate disregard as a remedy." 05-827 Pet. App. 15.[9]

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[9] The Bondholders' assertion that the Ninth Circuit "permitted substantive consolidation on facts like those at issue here" (05-941 Pet. 3) is

To try to establish that the decision below conflicts with the Sixth Circuit, petitioners cite *First National Bank v. Rafoth (In re Baker & Getty Financial Services, Inc.)*, 974 F.2d 712 (6th Cir. 1992). 05-827 Pet. 14, 16; 05-941 Pet. 10. *Rafoth*, however, involved an action to recover preferential payments received by a bank and to subordinate the bank's claim. The bank argued the operative date for computing the ninety-day preference period should be the date on which the estates were substantively consolidated, which was outside the preference period. The Sixth Circuit concluded the bank had not proved the debtors were not treated as one and the earliest filing date was the controlling date. This is not remotely similar to the issue the Third Circuit decided and is not evidence of a conflict.

2. The Bondholders also argue that a conflict among the circuits exists because the "Third Circuit concluded that the existence of separate guarantees * * * creates a per se bar on substantive consolidation." As supposedly conflicting authority, they cite *Soviero v. Franklin National Bank*, 328 F.2d 446 (2d Cir. 1964), as well as a number of lower court decisions, predominantly at the bankruptcy court level. 05-941 Pet. 13-16. The Third Circuit, however, did not state that guarantees create a per se bar on substantive consolidation. And though it is true, in the abstract, that intercorporate guarantees *can* support substantive consolidation, it is also irrelevant.

Soviero was the first decision to cite guarantees as a factor favoring consolidation. 328 F.2d at 448. That decision mentioned the issuance of consumer guarantees by sham retail affiliates in the name of the bankrupt parent company as part of a fact pattern showing hopeless financial entanglement and total disregard of corporate entities. Different types of guarantees have different consequences, which in some cases will support substantive consolidation (e.g., when guarantees are issued by real entities to induce creditors to deal with their sham alter

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puzzling. *Bonham* involved a Ponzi scheme, and this case involves an honest Fortune 200 corporation with audited financial statements and *no* allegations of any financial wrongdoing or victims.

egos) and in other cases will preclude it. The facts of *Soviero* are a paradigm for the former. In contrast, the guarantees in *this* case are the obvious paradigm for the latter because the Banks specifically bargained for, and relied on the existence and enforceability of, guarantees from legitimate, nonsham, separate entities as a credit enhancement to have direct claims against those guarantors. *FDIC v. Hogan (In re Gulfco Investment Corp.)*, 593 F.2d 921 (10th Cir. 1979), which the Bondholders cite in support of their argument (05-941 Pet. 13), actually supports the Third Circuit's ruling because the Tenth Circuit held that substantive consolidation could not be used to eliminate guarantees made by one debtor corporation to pay for the debt of another without compelling reasons.

3. The Bondholders heavily rely on the Third Circuit's prohibition on nonconsensual "deemed" consolidation and assert a conflict with other circuits in this regard. As a threshold matter, it is impossible to believe that any circuit could actually disagree with the Third Circuit's reasoning that, if multiple entities fooled creditors into thinking they were doing business with one entity, a bankruptcy court cannot possibly allow that skullduggery to continue by effecting consolidation only on a "deemed" basis. In any event, absolutely no appellate support for "deemed" consolidation exists – not one case.

Specifically, the Bondholders argue (05-941 Pet. 17-18) that the Third Circuit conflicts with the Sixth Circuit, citing a *bankruptcy court decision* that was affirmed by the Sixth Circuit. *In re Am. HomePatient, Inc.*, 298 B.R. 152 (Bankr. M.D. Tenn. 2003), *aff'd sub nom. Bank of Montreal v. Official Comm. of Unsecured Creditors (In re Am. HomePatient, Inc.)*, 420 F.3d 559 (6th Cir. 2005). In affirming the bankruptcy court's decision, however, the Sixth Circuit did not consider or discuss whether the "deemed" nature of the substantive consolidation should be deemed a fatal flaw. The Sixth Circuit did not consider whether the debtors should be substantively consolidated at all. Rather, the issues it decided were whether an appeal was equitably moot, a proper interest rate, and the appropriate valuation of a creditor's secured interest in the debtor's assets.

Even if a circuit conflict existed over this issue, this case would not be an appropriate vehicle to resolve it. The Third Circuit made it clear it would reach the same result without relying on this factor. The prohibition on "deemed" consolidation appears in a section of the opinion entitled "Other Considerations Doom Consolidation As Well." 05-827 Pet. App. 34.

Even at the non-appellate level, the Bondholders' assertion that many courts have approved chapter 11 plans providing for deemed consolidation (05-941 Pet. 18) is unavailing. Cases that have approved plans providing for deemed consolidation involved either *consensual* substantive consolidation or an express finding that substantive consolidation would harm no creditor. For example, *In re Genesis Health Ventures, Inc.*, 266 B.R. 591, 618-19 (Bankr. D. Del. 2001), *appeal dismissed*, 280 B.R. 339 (D. Del. 2002), permitted partial deemed consolidation that harmed no creditor. The consolidation issue in WorldCom, although initially hotly contested, was ultimately settled. *In re WorldCom, Inc.*, Ch. 11 Case No. 02-13533, 2003 WL 23861928, at *23 (Bankr. S.D.N.Y. Oct. 31, 2003).

4. The courts of appeals, rather than being in conflict, are in agreement on the key principles that make this case an exceptionally poor candidate for substantive consolidation. For example, every court of appeals agrees that substantive consolidation should be used "sparingly." *See, e.g., Bonham*, 229 F.3d at 767; *Reider v. FDIC*, 31 F.3d at 1109; *FDIC v. Colonial Realty Co.*, 966 F.2d 57 (2d Cir. 1992); *Eastgroup.*, 935 F.2d at 248; *Augie/Restivo*, 860 F.2d at 518. And every court of appeals agrees that substantive consolidation can be defeated by a showing that the opponents of substantive consolidation relied – as they did here – on the separate credit of entities that are proposed to be consolidated. The verbal formulations of this point may vary from circuit to circuit, but the substance is consistent.

For example, the D.C. Circuit, citing a Second Circuit decision, stated that if and after proponents of consolidation prove (i) substantial identity; and (ii) that consolidation is necessary to obtain some benefit or avoid some harm, substantive consolidation may be granted despite creditor reliance on

separate credit when the benefits "heavily outweigh" the harms. *Auto-Train*, 810 F.2d at 276 (citing *In re Continental Vending Machs. Corp.*, 517 F.2d 997, 1001 (2d Cir. 1975)). Petitioners fail, however, to cite any decisions concluding substantive consolidation is appropriate by simply applying a balancing test to overcome creditor reliance on separateness. There is no basis to believe the D.C. Circuit would have granted substantive consolidation if presented with the facts of this case.

Because the reliance test, on which all circuit courts agree, was originally formulated by Judge Friendly as a showing that creditors "relied on the separate credit" of the entities, *Chem. Bank N.Y. Trust Co. v. Kheel*, 369 F.2d at 848 (concurring opinion), petitioners take it as a given that many courts that have repeated Judge Friendly's phrase require an inquiry into the credit *metrics* that creditors used in determining whether to take guarantees from separate entities. *No* court of appeals, however, has *ever* inquired into a lender's credit metrics and held that reliance on the existence of separate entities in extending credit was insufficient because not enough diligence was applied in deciding the creditworthiness of the separate entities. Here, there is not even a materially different verbal formulation of the test by the courts of appeals. Rather, petitioners put their own gloss on what other courts have meant by "reliance on * * * separate credit," without citing the *facts* of any cases to support their gloss, and then argue that the Third Circuit departed from petitioners' own gloss.

To negotiate subsidiary guarantees in reliance on the separateness of subsidiaries *is* to rely on those subsidiaries' separate credit. What the Third Circuit made clear is that (i) reliance on separate credit is not an inquiry into what credit metrics a creditor uses to determine whether it wants guarantees from subsidiaries, as the district court erroneously believed, thus undermining as a matter of law the district court's purported "findings" about reliance; and (ii) the district court's cursory opinion simply overlooked the large evidentiary record, which showed that the "Banks knew a great deal about these subsidiaries." 05-827 Pet. App. 30.

5. Finally, petitioners attempt to demonstrate a conflict by quoting certain statements from the decision below to make the Third Circuit's holding seem sweeping. 05-827 Pet. 21; 05-941 Pet. 23. This "Court 'reviews judgments, not statements in opinions.'" *California v. Rooney*, 483 U.S. 307, 311 (1987) (per curiam) (quoting *Black v. Cutter Labs*., 351 U.S. 292, 297 (1956)); *accord Johnson v. DeGrandy*, 512 U.S. 997, 1003 n.5 (1994). Thus, the mere fact that the decision below used phrases such as "perfect storm," or disagreed with potential interpretations of the tests used by other courts of appeals, is irrelevant in determining whether a conflict among the courts of appeals exists. What is relevant is whether the Third Circuit's judgment in the decision below was in conflict with other courts of appeals deciding the same legal issue with very similar facts, which petitioners have failed to demonstrate.

II. THE DECISION BELOW IS PLAINLY CORRECT

The decision below does nothing more than reject the unprecedented offensive use of a power mentioned nowhere in the Bankruptcy Code to override contractual rights and shift a billion dollars of value from those who bargained for protection (in the form of subsidiary guarantees) to others who did not. The Banks provided a credit of $2 billion to a Fortune 200 company having audited financial statements and accurate corporate records, in exchange for guarantees from twelve of Owens Corning's subsidiaries. The notion that other creditors can deprive the Banks of the benefits of those guarantees in the name of expedition and simplification is an astonishing concept predictably condemned by the Third Circuit. *See also* Br. of Profs. Rasmussen et al. 10 (Dec. 29, 2004) ("it is difficult to conceive as to what bankruptcy policy could in this setting justify rupturing the corporate form and thereby rearranging the rights accorded to the Banks by virtue of the guarantees").

The Third Circuit correctly refused to grant substantive consolidation because it was being sought as a stratagem to strip the Banks of rights under the Bankruptcy Code, favor other creditors, and trump possible objections to the Plan by the Banks. Using substantive consolidation as an offensive weapon

in this manner would distort a doctrine intended to be invoked sparingly – and only when necessary to remedy harm caused by fraud, hopeless commingling of assets, or other corporate irregularities. This would not be equity; it would be an abuse of the bankruptcy process. *See Chem. Bank N.Y. Trust Co. v. Kheel*, 369 F.2d at 848 (Friendly, J., concurring) ("Equality among creditors who have lawfully bargained for different treatment is not equity but its opposite * * *.").

Granting consolidation on the facts of this case would undermine the Bankruptcy Code and render unreliable the whole concept of separateness of entities within commonplace corporate structures. *See United States v. Bestfoods*, 524 U.S. 51, 62 (1998). It would also allow substantive consolidation to serve as an end run around the well-established processes and doctrines for challenging a creditor's priority in bankruptcy.

Moreover, the decision below is supported by the record. Specifically, the record lacks the necessary evidence of disregard of corporate formalities and separateness to warrant substantive consolidation, while containing a plethora of undisputed facts and admissions that the subsidiaries' assets and liabilities were known and created for valid purposes and that corporate formalities and record books were properly kept. *See* pp. 3-4, *supra*. The subsidiaries had far too much substance and far too many assets for anyone even to allege that any fraud was involved in their formation. The record also contains no evidence that OCD's and its subsidiaries' way of doing business misled any creditor. The record is also clear that the Banks relied on the direct claims provided by the guarantees as providing additional value in the event of default. It overwhelmingly demonstrates the purpose of the guarantees was to give the Banks separate sources of recovery in the event OCD defaulted through the ability to bring direct claims against the subsidiaries that would rank ahead of the claims of OCD's own creditors, who had no direct claims against the subsidiaries.

The Bondholders argue that substantive consolidation is beneficial because it enables large corporate enterprises to achieve reorganization in a streamlined and expedited fashion.

05-941 Pet. 24. That argument is a euphemism for asserting that, when it is cumbersome for each corporate entity to comply with the Bankruptcy Code, the court should combine entities into one, regardless of the effect on individual creditors such as the Banks. Here, the merger of all subsidiaries into the parent severely impairs the Banks in two ways. First, it deprives them of the economic benefit of their guarantees, approximately $1 billion. Second, it deprives the Banks of votes on each individual subsidiary's chapter 11 plan, which votes would otherwise enable the Banks to prevent confirmation of plans that deprived them of their guarantee entitlements. In actuality, large corporations routinely reorganize without substantive consolidation. One of the largest chapter 11 reorganization cases is illustrative. In less than three years, Enron achieved confirmation of a joint plan that dealt separately with each of 177 debtors with no substantive consolidation. Additionally, simplifying and expediting resolution of a bankruptcy case is an insufficient reason to override the Banks' considerable, bargained-for rights. Moreover, disregarding bargained-for credit enhancements whenever doing so would simplify and expedite a bankruptcy case would result in disastrous consequences for credit markets.

Accordingly, the Third Circuit's decision was patently correct. As Dean Baird aptly observed:

> The district court decision had broken too much china. Substantive consolidation in such a case would have effectively undermined bank loans, totaling $2 billion, which had been made in a conventional and commercially reasonable way. Allowing substantive consolidation would have unsettled too many established practices.

Baird, *supra* note 5, at 14-15.

III. PETITIONERS MISCHARACTERIZE THE IMPORTANCE OF THIS CASE

This case was important at the Third Circuit: affirmance of the district court's decision would have jeopardized conventional commercial finance in the trillions of dollars, because lenders would no longer have been able to count on the enforceability

of guarantees entered into in "Lending 101" transactions. The Third Circuit's correction of a dangerous precedent is hardly an occasion for this Court to weigh in.

Petitioners ironically request review of the decision below to improve the "predictability" of the application of substantive consolidation so that parties may better order their "primary conduct." 05-941 Pet. 3, 28-29. But the decision below synthesizes other courts' discussions of the substantive consolidation doctrine into a clarity improving the predictability of the doctrine's application. Rather than adding to any prevailing uncertainty, the decision below clears up this area of law. And, because the decision below does not conflict with other courts of appeals, lenders have the requisite guidance to structure their loans. Review by this Court, therefore, is not necessary.

Contrary to petitioners' assertions (05-827 Pet. 25; 05-941 Pet. 27), the decision below will not inhibit the reorganization of large companies. As discussed above, large corporations routinely reorganize efficiently without the need to resort to substantive consolidation. In addition to the *Enron* case discussed above (p. 25, *supra*), Texaco and its subsidiaries reorganized in less than one year without substantive consolidation, as most all large companies do. Petitioners' argument that substantive consolidation is necessary to avoid the need for (i) multiple chapter 11 plans; (ii) separate votes by creditors; and (iii) the resolution of intercompany claims is audacious. It asks this Court to create (with no guidance from Congress) a doctrine allowing litigants to sidestep and evade the requirements of the Bankruptcy Code applicable to each and every debtor, when some litigants find that expedient and to their economic benefit. Petitioners are asking the Court to empower them to eliminate the Bankruptcy Code's application to each separate debtor-guarantor.

Substantive consolidation is nowhere authorized by the Bankruptcy Code except for spouses' estates, 11 U.S.C. § 302(b). The Third Circuit declined to hold that it is therefore completely unauthorized in corporate reorganizations, 05-827 Pet. App. 20-22 n.14, but the basic jurisprudential principle of

respect for corporate separateness and the absence of express statutory authority render suspect any use of this power when not absolutely necessary, and certainly suggest that it is not an available offensive power to defeat bargained-for contractual rights to the tune of a billion dollars.

Petitioners assert that the decision below is significant because tort claimants are excluded from the first prong of the Third Circuit's test (i.e., separateness was disregarded so significantly that creditors relied on the breakdown of entity borders and treated them as one legal entity). 05-827 Pet. 24. That exclusion, however, is unremarkable. Tort claimants are excluded because they are involuntary creditors by definition. As such, they are unable to "rely" on the breakdown of entity borders, on the one hand, or the separate identity or credit of the entities, on the other hand. As quoted by petitioner FR, "'unlike voluntary creditors, tort claimants are unable to bargain for protection.'" 05-827 Pet. 25 (quoting Christopher W. Frost, *Organizational Form, Misappropriation Risk, and The Substantive Consolidation of Corporate Groups*, 44 HASTINGS L.J. 449, 452-53 (1993)). The Third Circuit simply expressed what was implicit in the decisions of the other courts of appeals.

Petitioner FR further attempts to demonstrate the importance of the decision below by contending the Debtors' chapter 11 cases should be concluded expeditiously because asbestos victims have been awaiting compensation for their injuries. 05-827 Pet. 24. However, the goal of effectuating a prompt emergence from bankruptcy is not a legitimate excuse to invoke the doctrine of substantive consolidation. If it were, Congress would have provided in the statute that multiple debtors can merge to save time in their reorganizations. The raw desire to get out of bankruptcy quickly cannot justify prejudicing rights of creditors, such as the Banks, who relied on the separateness of the guarantor subsidiaries. Moreover, granting certiorari in this case would not expedite the conclusion of the Debtors' chapter 11 cases. After the Third Circuit rendered its decision below, the Debtors modified their Plan such that it no longer provides for the deemed consolidation of

the Debtors. The modified plan was filed on December 31, 2005. The bankruptcy court has already scheduled a hearing to consider confirmation of the modified plan. Accordingly, granting certiorari might serve only to delay further the conclusion of the Debtors' chapter 11 cases and therefore delay any distributions that will ultimately be made to the "numerous sick and dying asbestos victims." 05-827 Pet. 24.

IV. THE THIRD CIRCUIT DID NOT VIOLATE FED. R. CIV. P. 52

Petitioner FR contends this Court should grant certiorari because the Third Circuit failed to accord proper deference to what are asserted to be findings of fact in the district court's opinion. 05-827 Pet. 26-29. This contention is wholly incorrect and does not warrant a grant of certiorari.

As stated above, the district court's general and conclusory observations (including a very small number that might be characterized as findings of fact) in a cursory opinion were made by Judge Fullam, who did not preside over the trial, but rather reviewed the written record after replacing the judge who presided at trial. His opinion starts by explaining he read the transcript of the "four-day evidentiary hearing." 05-827 Pet. App. 46. The evidentiary hearing was thirteen days.

In an admirable discharge of its duties, the Third Circuit reviewed the record itself. Doing so hardly constituted disregard of Fed. R. Civ. P. 52(a), as petitioner FR asserts. Rather, a review of the factual observations made by the Third Circuit shows it reviewed the record and realized there were many topics and areas where Judge Fullam simply failed to make findings of fact (*see* 05-827 Pet. App. 2) or overlooked major portions of the record.

The "unless clearly erroneous" standard of review in Rule 52(a) applies only to appellate review of findings of fact. It does not apply to the district court's conclusions of law, which the appellate court reviews de novo. *See, e.g., Bose Corp. v. Consumers Union, Inc.*, 466 U.S. 485 (1984) (court of appeals was correct in reviewing determination of actual malice under

de novo standard even though underlying facts might be subject to review for clear error).

Many of the district court's statements that petitioner FR describes as "findings" were broad legal conclusions or mixed conclusions of facts and law, not entitled to appellate deference. For example, petitioner FR faults the Third Circuit for concluding the district court's "factual findings" of substantial identity were incorrect. 05-827 Pet. 28-29. What the Third Circuit actually held, however, is that the district court's "*conclusions* of substantial identity" were incorrect. 05-827 Pet. App. 29 (emphasis added). Because those conclusions were based on an erroneous view of the law of substantive consolidation, they suffered from legal error as to what substantial identity connotes, which is always reviewable de novo.

Petitioner FR also contends (05-827 Pet. 28-29) the Third Circuit misapprehended facts relating to (i) the integrated operation of the entire enterprise; and (ii) whether the Banks relied on the full contractual benefit of the guarantees they explicitly negotiated in what the Third Circuit described as the "'deal world' equivalent of 'Lending 101.'" 05-827 Pet. App. 28. None of the alleged facts to which petitioner FR refers, however, even if true, would have changed the outcome.

For example, the district court simply found customary, operational coordination among the corporate parent and its subsidiaries. 05-827 Pet. 28 (citing 05-827 Pet. App. 50-51). Those types of routine corporate synergies fall far short of the types of disregard of corporate separateness required by any circuit to justify the application of substantive consolidation. The Third Circuit correctly observed that the record demonstrated – through stipulations – that OCD's subsidiaries kept separate and detailed financial records, intercompany transactions were regularly documented, and great pains were taken to observe corporate formalities on a regular and ongoing basis. 05-827 Pet. App. 28-31. Furthermore, the terms of the Credit Agreement themselves, particularly Sections 8.01, 8.02, 8.07(b), 8.07(n), 8.09, 8.12, and 9.01(d)(ii), make it clear that the agreement was designed to protect the separateness of OCD

and its subsidiaries. The district court's opinion, in contrast, did not say a word about the meaning of the Credit Agreement.

The district court did "find" that the Banks' subjective purpose in obtaining the guarantees was to avoid structural subordination rather than attain structural seniority. That finding, however, was both legally irrelevant and clearly erroneous. As the Third Circuit explained, "[w]hat the Banks got in lending lingo was 'structural seniority.'" 05-827 Pet. App. 28. Moreover, no case has ever held that the subjective purpose of a party in negotiating a contractual provision that relies on corporate separateness can be used as a basis to defeat rights obtained in those negotiations.

The Third Circuit did not violate Rule 52(a) by declining to join in the district court's mixed conclusions of fact and law. This Court does not grant certiorari to opine on how a court of appeals must deal with a seven-page decision oblivious to the bulk of the admitted and undisputed facts in more than 10,000 pages of transcript.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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