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Bullard Is Bad News For Debtors And Creditors Alike

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Michael B. Kimberly

It's a good sign that common sense is on your side when, as a debtor in bankruptcy, your case makes it to the U.S. Supreme Court and one of the world's largest banks and the United States government both support your position on the merits. But, as we all learned earlier this month in Bullard v. Blue Hills Bank, common sense isn't always enough to win a case.

Underlying the question presented in Bullard was petitioner Louis Bullard's proposal, as part of his Chapter 13 repayment plan, to split his underwater mortgage into a secured claim backed by his home and an unsecured claim in the amount owed above the value of the home. Whereas the secured portion would have been repaid in full over time, the unsecured portion would have been repaid at a small fraction of its value, with the remainder being discharged. The net result would have been something akin to a compulsory principal-reduction loan modification.

Bullard's bank — then known as Hyde Park Savings Bank and now known as Blue Hills Bank — naturally objected to the hybrid treatment of the mortgage, arguing that it was impermissible under the Bankruptcy Code. The bankruptcy court agreed and denied confirmation of the repayment plan, setting up the question that would ultimately lead the Supreme Court to grant certiorari: whether an order denying confirmation of a bankruptcy plan is a final order, immediately appealable as of right.

To those more familiar with civil litigation, that question may seem strange: in ordinary civil cases, interlocutory denials of relief are not thought of as final, and they certainly aren't appealable. But bankruptcy courts — which, in actuality, are Article I tribunals operating under the supervision of the district courts — work differently. According to Section 158(a) of the Bankruptcy Code, district courts (or, sometimes, bankruptcy appellate panels) have jurisdiction to hear appeals "from final judgments, orders, and decrees ... entered in cases and proceedings referred to bankruptcy judges." From there, Section 158(b) gives the circuit courts jurisdiction over second-level appeals from "all final decisions, judgments, orders, and decrees" entered by district courts under paragraph (a).

The questions that follow are predictable: What is an "order" in a "proceeding," and when is it "final"? And that is just what was at issue in Bullard. The question in that case, more specifically, was whether a

debtor's proposal of, a creditor's objection to, and a bankruptcy judge's denial of a repayment plan is a discrete "proceeding," so that the denial of a repayment plan is a final order subject to immediate appeal under Section 158(b); or if, instead, the relevant "proceeding" is the entire plan process culminating in a plan's approval, so that only the confirmation of a plan is immediately appealable. The Supreme Court adopted the latter understanding, holding that confirmations of plans, but not denials, are immediately appealable. In reaching that decision, the court stuck primarily to the text of the statute.

While the court's plain-text analysis is fairly debatable (what, really, is a "proceeding"?), it is not the textual interpretation that is troubling — it is the practical consequences that are likely to follow from it.

The Bankruptcy Code's allowance for appeals from final orders in subsidiary contested matters and adversary proceedings is essential to the proper functioning of the system. Unlike civil litigation, which concludes with a single final judgment, bankruptcy cases comprise numerous discrete "proceedings" that resolve parties' substantive rights — whether a debt is owed, whether a debt is secured, whether a transfer is avoidable, and so forth. Those discrete proceedings are resolved on a rolling basis. If an appeal from each such proceeding were delayed for potentially years until the conclusion of the entire bankruptcy, the estate's assets might by then be distributed or other event may have occurred, leaving no practical recourse for a creditor whose proof of claim was wrongly denied or categorized.

Perhaps even more important is the ability to appeal orders concerning the confirmation of a repayment plan. A repayment plan is the blueprint for the ultimate resolution of a bankruptcy, detailing how debts are to be treated and assets distributed. Although the negotiation of such plans is ideally cooperative, many times creditors will object to proposed plan terms. When a plan is confirmed over an objection, the right to an immediate appeal is critical because once a plan is confirmed by the bankruptcy court, distributions to creditors begin right away. It would make little sense to appeal the terms of a plan at the closing of a bankruptcy case (which is little more than a ministerial act), after the ship had already left the port.

The same observation holds just as true for denials of proposed plans. If a debtor believes that a particular term of his proposed plan is permissible, but the bankruptcy judge disagrees, an appeal of the plan denial will become essentially pointless if the debtor is not permitted to appeal immediately. The Supreme Court acknowledged as much. In response, it explained only that the prospect that plan denials are, by dint of its holding, now essentially nonappealable "is made tolerable in part by our confidence that bankruptcy courts, like trial courts in ordinary litigation, rule correctly most of the time." But that is cold comfort to both creditors and debtors on either side of fundamental bankruptcy issues that have divided the bankruptcy courts.

The upshot is that, without an immediate appeal as of right from the denial of a repayment plan, a plan denial is very unlikely to receive any appellate review at all. That is a problem because appeals to the circuit courts — the only courts, aside from the Supreme Court, that issue opinions with controlling precedential weight in bankruptcy — are already relatively rare in Chapter 13 cases. Individual debtors in bankruptcy are typically short on funds and often unable to bear the substantial costs associated with prolonged litigation through two stages of appellate review. As a result, Chapter 13 bankruptcy law can be slow to develop, even with respect to important issues over which the bankruptcy courts and district courts disagree. And the resulting variability of substantive rules across jurisdictions imposes substantial costs on regional and national banks that do business in more than one jurisdiction. In circumstances like those, there is great value in the development of controlling appellate law that conclusively resolves such conflicts, rather than requiring creditors to engage in repeated case-by-case litigation.

The unavailability of appeals from confirmation denials will slow the orderly development of a uniform body of bankruptcy law even further. Once again, Bullard's case proves the point. It is questionable whether mortgages can be divided into secured and unsecured portions (at least in the manner proposed in Bullard), but it nevertheless is an issue that has split the bankruptcy courts and district courts. As Bank of America noted in its amicus brief, other significant and divisive bankruptcy issues linger unresolved. By making it nearly impossible to appeal plan denials that turn on the resolution of such questions, the Supreme Court's decision in Bullard will reduce yet further the opportunities that the courts of appeals have to issue controlling decisions on such questions.

That is all the more so because, as the Supreme Court recognized, "[t]he knowledge that he will have no guaranteed appeal from a denial should encourage the debtor to work with creditors and the trustee to develop a confirmable plan" expeditiously at the outset. While that is a positive development when viewed one case at a time, it means even less frequent appellate review of questions that may well be fundamental to the plan confirmation process, and as to which creditors — seeking to avoid the uncertainty, time and expense of one-case-at-a-time litigation — may prefer controlling appellate decisions.

In short, according to the Supreme Court, the text of Section 158 trumps common sense. Now that the Supreme Court has spoken, the ball is in Congress' court.

—By Michael B. Kimberly, Mayer Brown LLP

Michael Kimberly is an associate in Mayer Brown's Washington, D.C., office. He briefs and argues complex appeals and dispositive motions with primary focus on the antitrust laws, environmental law and constitutional law.