No. 15-1223

In the Supreme Court of the United States

SOUTHWEST SECURITIES, FSB, PETITIONER

v.

MILO H. SEGNER, JR., TRUSTEE.

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

REPLY BRIEF FOR THE PETITIONER

PAUL B. GEILICH
KIRTE M. KINSER
FISHMAN JACKSON PLLC
13155 Noel Road, Suite 700
Dallas, TX 75240

PETER K. STRIS
BRENDAN S. MAHER
DANIEL L. GEYSER
Counsel of Record
DOUGLAS D. GEYSER
STRIS & MAHER LLP
725 S. Figueroa St., Ste. 1830
Los Angeles, CA 90017
(213) 995-6811
daniel.geyser@strismaher.com

Counsel for Petitioner

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Page

Cases—continued:

Constitution and statutes:

REPLY BRIEF

The trustee's "response" in opposition is no response at all. It is simply a 25-page assault on a strawman, predicated entirely on a fundamental misrepresentation of the actual question presented by the petition.

This case presents a textbook question of statutory interpretation: under 11 U.S.C. 506(c), do secured creditors "benefit" from a trustee's ordinary costs of maintaining encumbered property before that property is abandoned? This question has hopelessly confused lower courts and triggered an acknowledged circuit conflict. It is undeniably important and frequently recurring—indeed, it arises in virtually every major bankruptcy.

This case is an ideal vehicle for resolving this significant issue. The question was outcome-determinative below. There is no dispute between the parties over *any* material facts. And this is the rare case where the issue percolated up to the court of appeals despite the usual economics of bankruptcy litigation.

In his opposition, respondent simply refuses to address the question presented. Instead, respondent mischaracterizes the petition as attempting to read an "intent" requirement into Section 506(c). As explained below, respondent's polemic about a trustee's "intent" answers a question that no one asked. The *actual* question checks off every box for further review. Certiorari is warranted.

A. Respondent Distorts The Question Presented

1. As previously explained, this case presents an important legal question that is ubiquitous in ordinary bankruptcies. This is the common fact-pattern: there is a

secured interest in property; there is a bankruptcy; the trustee elects to retain the property; the trustee incurs ordinary maintenance expenses; the trustee later abandons the property. Does the money spent in the interim (to preserve the status quo) "benefit" the secured creditor for purposes of Section 506(c)?

Those are the only relevant facts, and they are undisputed here. The issue is a simple, important, and recurring question of federal bankruptcy law. Its answer directly affects how Congress intended courts under Title 11 to divide up limited resources: either those maintenance costs come out of the bankruptcy estate or they come out of assets returned to secured creditors. That is exactly the kind of important, binary question that requires certainty and uniformity under the Bankruptcy Code. See U.S. Const. Art. I, § 8, cl. 4.

Yet as it stands today, the Fifth Circuit holds that secured creditors must pay pre-abandonment expenses (Pet. App. 12a-16a), whereas the Seventh and Eighth Circuits hold the opposite (*In re Trim-X, Inc.*, 695 F.2d 296, 300-301 (7th Cir. 1982); *Brookfield Prod. Credit Ass'n* v. *Barron*, 738 F.2d 951, 953 (8th Cir. 1984)). That square conflict over a significant question of law warrants the Court's review.

2. In an attempt to sidestep this critical question, respondent rests his entire brief on a deep misunderstanding of Southwest's position. According to respondent, Southwest reads an "intent" requirement into Section 506(c). Respondent insists that, under Southwest's position, a trustee must "specifically intend to benefit the secured creditor—and no one else"—for Section 506(c) to apply. Opp. 11. In mischaracterizing Southwest's position, respondent simply *assumes* that secured creditors "benefit" from pre-abandonment maintenance expenses.

Respondent is confused. Our position is that the trustee's expenses in preserving the status quo *do not "benefit" secured creditors* for purposes of Section 506(c). It makes no difference what the trustee "intended"; all that matters is that the trustee elected to keep encumbered property rather than abandon it to secured creditors. Costs that preserve the status quo in the interim are not "benefits" under Section 506(c); those costs merely avoid harm, which is insufficient to invoke Section 506(c)'s "extraordinary" surcharge remedy. Pet. 11 (citing cases).

Having distorted the actual question presented, respondent claims that there is no circuit split, the question is fact-bound, and Southwest is wrong on the merits. Opp. 8-9. Not so. To be clear, our position has nothing to do with the trustee's intent; it has to do with whether secured creditors "benefit," within the meaning of Section 506(c), from preserving the status quo before property is abandoned. As the Fifth Circuit itself recognized, there is an unambiguous split over *that* question, and it is hardly fact-bound. The answer hinges on the meaning of "benefit" under the statute; the trustee's intent is irrelevant.[1]

---

[1] Respondent focuses on the word "hope" in Southwest's question presented (asking whether secured creditors must pay when trustees "retain[] encumbered property in the hope of benefiting other creditors"). Respondent misses the point. Trustees always retain property to benefit other creditors. That "hope" merely explains why the property was not immediately abandoned. See 11 U.S.C. 554(a). Southwest stressed the trustee's intent for a simple reason: it underscores the unfairness of a trustee refusing to abandon property to secured creditors and then charging secured creditors for the trustee's privilege of keeping the property. "Intent" is irrelevant to whether secured creditors "benefit" from the estate's costs while the estate keeps the property.

B. Respondent Misrepresents The Facts

In attempting to dodge review, respondent tries to muddy the factual record, but his assertions are meritless.

First, respondent suggests that Southwest *consented* to the surcharge. Opp. 3, 7, 13. That is demonstrably false. Southwest repeatedly objected to any surcharge for maintenance costs, and it explicitly reserved its "defenses" to a Section 506(c) surcharge at two separate points in the confirmed plan. C.A. Rec. 97, 103. Indeed, on the same transcript page that respondent cites (at 3), respondent's own counsel "admit[s] that the plan does not require a surcharge." *Id.* at 1950. If Southwest had actually consented, one would presumably find some hint of that critical fact somewhere in the opinions below. Instead, one finds the opposite: "Southwest objected to the requested surcharge." Pet. App. 5a.[2]

Second, respondent maintains that, once the trustee finally agreed to turn over the property, Southwest opposed abandonment. Opp. 8. Respondent's assertion is obviously misleading. Southwest opposed abandonment only to the extent that *the trustee conditioned abandonment on surcharging its pre-abandonment expenses*. C.A. Rec. 1776, 1803-1806. Notably, five days after the

---

[2] Respondent states that Southwest knew the trustee would keep and maintain the property. True, but irrelevant. Given the property's perceived value, Southwest knew that moving immediately to lift the automatic stay and foreclose would have been futile. Southwest could not prevent respondent from keeping the property, see 11 U.S.C. 362(a), 554(b), but Southwest had every right to insist that the trustee honor his statutory obligation to preserve the property and avoid waste, see 11 U.S.C. 503(b)(1)(A), 704(a)(2). Southwest did not "consent" to surcharge by invoking the trustee's traditional legal duties.

trustee's motion to abandon was filed, Southwest offered to take the property and reimburse respondent for all expenses *subsequent* to the motion's filing. *Id.* at 1803, 2081. Southwest's "opposition" simply mirrors the issue presented in the petition.

Third, respondent highlights Southwest's "concession" that failing to maintain the property would "destroy [its] value." C.A. Rec. 2081. Respondent is confused. Trustees have a preexisting obligation not to impair or destroy estate property; the question is whether merely honoring that obligation confers a "benefit" under Section 506(c). No one disputes that the trustee's pre-abandonment expenses were "reasonable" and "necessary" for "preserving" the status quo. 11 U.S.C. 506(c). The only dispute is whether such expenses "benefit" secured creditors (per the Fifth Circuit), or not (per the Seventh and Eighth Circuits). The fact that failing to maintain the property would "destroy [its] value" only confirms this case is a clean vehicle for resolving the issue.

As explained above, every *material* fact here is undisputed: the trustee retained encumbered property, incurred costs to preserve the status quo, and then finally abandoned that property to Southwest. The question is whether those pre-abandonment expenses "benefit[ed]" Southwest under Section 506(c). That question arises directly out of the uncontested facts, and it is appropriate for immediate review.

C. The Question Presented Meets All The Traditional Criteria For Further Review

Perhaps realizing that this case checks off every traditional box for review, respondent refuses to engage the question presented, focusing instead on irrelevant issues concerning the trustee's "intent." Respondent either fundamentally misunderstands the dispositive legal is-

sue, or he has no persuasive rebuttal to Southwest's true position. On a fair reading, the familiar criteria for further review are satisfied.[3]

1. This issue has squarely divided the circuits, and respondent's contrary suggestion is baseless. The Fifth Circuit meant what it said when it rejected *Trim-X*'s "holding" as "[un]persua[sive]." Pet. App. 13a-14a (describing the Seventh Circuit's "rule"). And the Fifth Circuit's (correct) understanding of *Trim-X* is unambiguous:

> As relevant here, the trustee sought to surcharge expenses incurred between the start of the bankruptcy case and the date on which the trustee moved to abandon the property based on an appraisal that showed that the stored goods had no equity. Although it acknowledged that the secured creditor benefited from the expenses "in the sense that it received the assets unharmed," the Seventh Circuit agreed with the bankruptcy court's conclusion that "expenses incurred prior to the time the trustee determined [the debtor] had no equity in the assets were not for the benefit of [the secured creditor]."

Pet. App. 13a. Had the Fifth Circuit applied that holding, the outcome here would be exactly the opposite. The

---

[3] Below, Southwest also pressed a separate argument regarding "intent." Pet. App. 7a. But that *distinct* issue is irrelevant to Southwest's petition, and the operative question was unambiguously raised and resolved below. *E.g.*, Pet. App. 13a-14a (specifically rejecting the "rule," from *Trim-X* and other cases, "foreclosing the possibility of Section 506(c) surcharge for any expenses incurred prior to attempted abandonment"); *id.* at 18a (rejecting "Southwest's articulated rule that would preclude surcharge of pre-abandonment expenses"). Respondent may prefer to defend different issues, but he cannot wish away the question presented.

split is both stark and acknowledged, and it was deliberately created by the court of appeals below. The contrary rule has been applied consistently in the Seventh Circuit for over three decades. There is no conceivable basis for thinking this direct conflict will resolve itself.

In resisting this conclusion, respondent (aside from invoking its "intent" strawman)[4] brushes aside the Seventh Circuit's legal rule as a fact-bound holding. Opp. 19-20. That is obviously wrong. The Seventh Circuit set forth a clear legal rule that trustees may not surcharge their ordinary expenses while retaining property for the estate. 695 F.2d at 301. The fact that it *applied* that legal rule to the facts of the case does not make it any less a *legal rule*—which is precisely why the Fifth Circuit acknowledged its decision departed from the Seventh Circuit's "*holding*." Pet. App. 14a; see also, *e.g.*, *Heidelberg Harris, Inc.* v. *Grogan (In re Estate Design & Forms, Inc.)*, 200 B.R. 138, 142 (E.D. Mich. 1996) (under *Trim-X*, pre-abandonment "'preservation expenses'" could not be surcharged); *In re Proto-Specialties, Inc.*, 43 B.R. 81, 84 (Bankr. D. Ariz. 1984) (interpreting *Trim-X* as "establish[ing] a cleavage date": "expenses incurred prior to trustee's abandonment petition held estate liability; post-abandonment expenses to be paid by secured creditor"); *In re Wiltwyck Sch.*, 34 B.R. 270, 274-275 (Bankr. S.D.N.Y. 1983).[5]

---

[4] Opp. 18, 20-22 (dismissing *Trim-X*, *Brookfield*, and other cases for not addressing the trustee's "intent").

[5] Respondent suggests that the Fifth Circuit merely discussed Southwest's "read[ing]" of *Trim-X*. The panel repeatedly described this "reading" as the Seventh Circuit's "holding" (Pet. App. 14a, 15a n.10), which is exactly what it was. *E.g.*, *Heidelberg Harris*, 200 B.R. at 142 (following *Trim-X* as "telling" on this "question of law").

Respondent similarly misreads the Eighth Circuit's holding in *Brookfield*. As previously explained (Pet. 8-9), *Brookfield* held that secured creditors do not "benefit" where the status quo is merely preserved while property remained in the debtor's control. Those expenses were incurred under "'the debtor's independent duty of reasonable care regarding the property in his possession,'" and the debtor could not shift those costs (pre-foreclosure) to the secured creditor. 738 F.2d at 952-953. Respondent may not understand that holding, but *Brookfield*'s dissent surely did: "the court holds that the [debtors] may not recover the reasonable and necessary expenses incurred in preserving the collateral because these expenditures did not benefit the creditor." *Id.* at 953 (Bright, J., dissenting).

In addition to trotting out the mistaken "intent" point, respondent distinguishes *Brookfield* on the ground that the secured creditor did not "benefit" because the debtor "sold the secured creditor's collateral" and ultimately kept "the proceeds of the sale" for itself. Opp. 20-21. Respondent is again confused. While *some* collateral was sold, the *remaining* collateral was not—which is precisely why the secured creditor "instituted foreclosure proceedings." 738 F.2d at 952. The operative holding applies to that remaining collateral, and it is directly at odds with the Fifth Circuit's decision.

The 2-1 circuit split is clear and intractable. The Seventh and Eighth Circuit decisions have been on the books for decades; there is no reason to think they will suddenly reverse course and adopt the Fifth Circuit's contrary view. And for nearly three decades now, the surcharge issue has plagued bankruptcy courts, with judges recognizing it has generated "'more controversy [than] any field I know.'" *C.I.T. Corp.* v. *A&A Printing, Inc.*, 70 B.R. 878, 879-880 (M.D.N.C. 1987); see also *In re*

Mall at One Assocs., L.P., 185 B.R. 981, 988 (Bankr. E.D. Pa. 1995) (recounting courts' struggle with the appropriate test); *In re Wyckoff*, 52 B.R. 164, 165 (Bankr. E.D. Mich. 1985) (describing "huge" "volume of caselaw on the question"); compare, *e.g.*, *In re Midatlantic Bank, N.A.* v. *Peco Energy Co.*, Nos. 94-7499+, 1996 WL 135339, at *3 (E.D. Penn. Mar. 19, 1996) (finding "benefit" from utility costs to preserve collateral), with *In re HC Walden Props., L.L.C.*, No. 10-52106, 2012 WL 3263609, at *3 (Bankr. D. Conn. Aug. 9, 2012) (finding no "benefit" from such costs). This persistent confusion will only get worse without this Court's intervention, and it is unclear when the Court will face another opportunity to resolve the issue. This is the rare case that reached the court of appeals, and this Court's review is urgently needed.

2. The proper construction of Section 506(c) is a recurring question of great importance. Pet. 13-16. Respondent argues that the issue somehow "frequently" recurs without being frequently recurring: respondent admits (as he did *twice* before) that the issue arises all the time in ordinary bankruptcies. Opp. 15; C.A. Br. 48. But respondent says that this "very important" issue does not "recur" because he has "never before encountered" Southwest's particular argument. Opp. 16; C.A. Opp. To Stay Mandate 4. This is puzzling. This *issue* arises every time a trustee retains encumbered property for the estate. That situation is commonplace in bankruptcy—indeed, it arises every time a trustee retains property to assess its value. And Southwest's "argument" is hardly unfamiliar: it has been the law in multiple courts (including two circuits) for decades. It turns on the clear *lack* of any "benefit" where a trustee refuses to transfer property but still insists that secured creditors foot the bill for ordinary maintenance. *E.g.*, *Heidel-*

berg Harris, 200 B.R. at 143 (adopting *Trim-X*: "[m]ere expenses of retaining possession during the period before abandonment are not subject to a surcharge"). That decision to leave property "unharmed" is not a "benefit" under Section 506(c), which is why Southwest would have prevailed had this case arisen in Illinois or Missouri, not Texas.

3. This is an ideal vehicle for considering the question presented. Again, every material fact is undisputed. The vast majority of the trustee's expenses were for ordinary maintenance ("security," "mowing and shrub control," "utilities," and "insurance," Pet. 17 (quoting respondent's brief)). All agree that the trustee's expenses were otherwise "necessary" and "reasonable," thus satisfying Section 506(c)'s other factors. There are no alternative grounds for affirmance, and no other factual questions that might affect the inquiry (but might arise in other cases, *e.g.*, whether Southwest's lien was perfected). The entire dispute turns on a simple but important question of law, and this is the perfect opportunity to resolve it.[6]

D. Respondent's Merits Arguments Underscore The Need For Immediate Review

In defending the decision below, respondent argues that Section 506(c) lacks an "intent" element. Opp. 10-15. Since no one thinks otherwise, respondent's merits argument (like the majority of his brief) is irrelevant.

Southwest will reserve an extended discussion of the merits for plenary review. For now, it is enough to note that respondent offers no response to Southwest's *actual*

---

[6] Respondent insists the meaning of "benefit"—a *statutory* term—is a "question of fact." Opp. 23. No circuit (including the court below) agrees with respondent's unusual understanding of statutory construction.

merits position, which is this: Trustees are already obligated (by operation of law) to avoid waste or impairment of estate property. 11 U.S.C. 503(b)(1)(A), 704(a)(2). They have a fiduciary duty to maintain that property in its condition as of the petition date. Pet. 11-12. If the estate abandons property, the estate does not have to pay for that property. But until that occurs, secured creditors do not "benefit" from the trustee doing precisely what he was already obligated to do.

For years, Southwest's reading of Section 506(c) has been the law in the Seventh and Eighth Circuits. Unlike the Fifth Circuit's holding, the majority rule is simple and easy to administer; it is consistent with the traditional rule that estate funds pay for estate costs; it cabins Section 506(c) to the narrow set of cases that Congress intended; it protects the value and integrity of secured liens (which are supposed to pass through bankruptcy unaffected); and it comports with basic notions of fairness—a party should not be forced to shoulder the expenses of ownership without actually owning anything. Pet. 10-13; *e.g.*, *In re Ware*, No. 12-30566-KLP, 2014 WL 2508731, at *7 (Bankr. E.D. Va. June 3, 2014); *In re TIC Memphis RI 13, LLC*, 498 B.R. 831, 836 (Bankr. W.D. Tenn. 2013).

The Fifth Circuit misunderstood the meaning of "benefit" under Section 506(c), and its decision promises to add confusion to an issue that has already confounded the lower courts. Further percolation will only make the situation worse. Review is warranted to bring uniformity to this important bankruptcy-law question.

CONCLUSION

The petition should be granted.

Respectfully submitted.

PAUL B. GEILICH
KIRTE M. KINSER
FISHMAN JACKSON PLLC
13155 Noel Road, Suite 700
Dallas, TX 75240

PETER K. STRIS
BRENDAN S. MAHER
DANIEL L. GEYSER
Counsel of Record
DOUGLAS D. GEYSER
STRIS & MAHER LLP
725 S. Figueroa St., Ste. 1830
Los Angeles, CA 90017
(213) 995-6811
daniel.geyser@strismaher.com

JULY 2016