ALERT
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Supreme Court Adopts Deferential Standard of Review on Chapter 11 Insider Status

In *U.S. Capital Bank N.A. v. Village at Lakeridge, LLC*, No. 15-1509 (U.S. Mar. 5, 2018), the U.S. Supreme Court held that an appellate court should apply a deferential standard of review to a bankruptcy court's decision as to whether a creditor is a "nonstatutory" insider. Nonstatutory insiders are creditors who are not specifically designated as insiders under the Bankruptcy Code (such as officers, directors, and controlling shareholders), but who the bankruptcy court determines nonetheless have sufficient influence over a debtor to be deemed insiders. The votes of insiders, including nonstatutory insiders, to accept a chapter 11 plan do not count in determining whether the plan has been accepted by at least one class of impaired claims, a requirement for the bankruptcy court to confirm the plan.

Chapter 11 debtor Lakeridge, LLC ("Lakeridge") was unable to obtain confirmation of its chapter 11 plan because the only impaired secured creditor that supported the plan—sole shareholder and secured creditor MBP Equity Partners ("MBP")—was an insider. MBP therefore sold its $2.8 million secured claim for $5,000 to an individual who then voted for the plan. On the basis that the buyer was romantically attached to an MBP board member and Lakeridge officer, Lakeridge's secured bank lender objected to confirmation. It argued that the buyer of the claim was also disqualified from voting on the plan as a nonstatutory insider.

The bankruptcy court confirmed the chapter 11 plan, finding that the claim transfer was conducted at arm's length and that the buyer, thus, was not a nonstatutory insider. A divided U.S. Court of Appeals for the Ninth Circuit affirmed, ruling that the bankruptcy court's finding was entitled to deference as not being "clearly erroneous," rather than being subject to "de novo" review.

Writing for the unanimous court, Justice Kagan affirmed the approach of the Ninth Circuit. She explained that the bankruptcy court is better situated to determine the "mixed question" of law and fact of whether a creditor is a nonstatutory insider, at least when the question is the fundamentally factual one of whether a transaction was conducted at arm's length. In such a case, the deferential standard of appellate review for questions of fact should apply. The Court, however, both assumed the correctness of the Ninth Circuit's standard for identifying a nonstatutory insider (which four justices, in a concurring opinion, called into question) and recognized that even that standard might in a different circumstance (involving a second prong of that standard, not at issue in this case) call for a different standard of review. Thus, the Court's decision, while somewhat clarifying, may spawn further uncertainty.

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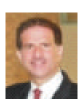
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