



Bankruptcy & Financial Restructuring ADVISORY ■

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U.S. Supreme Court Bolsters Clear Error Standard for Mixed Questions of Fact and Law

On March 5, 2018, the U.S. Supreme Court considered the question of what standard an appellate court should apply in its review of a bankruptcy court's conferral of "non-statutory insider" status. The practical significance of the analysis is that the votes of insiders are not counted when determining the acceptance of a class for purposes of confirmation of a plan under Section 1129(a)(10) of the Bankruptcy Code. Having at least one class of impaired claims accept a plan is an essential component of "cramdown" of a plan on dissenting classes of claims. The \$2.76 million claim at issue was sold by an insider to a third party for \$5,000, and the bankruptcy court determined that the buyer of the claim was not an insider despite having a disclosed "romantic" relationship with the insider seller of the claim.

It is well-settled that decisions made by reviewing courts on questions of law are reviewable de novo – where the appellate court acts as if it were considering the question for the first time and without deference to the decision from the court below. It is equally axiomatic that "factual findings are reviewable only for clear error—in other words, with a serious thumb on the scale for" the court acting as the trier of fact. Issues often arise over the standard of review for determinations made in so-called "mixed questions" of law and fact, where the relevant inquiry is whether a set of established facts satisfy a statutory standard.

In *U.S. Bank N.A. v. Village at Lakeridge LLC*, the Supreme Court ruled that the Ninth Circuit Court of Appeals properly applied the "clear error" standard to one such mixed question in its review of a bankruptcy court determination about whether an individual qualified as a non-statutory insider. In reaching this conclusion, the Court posed the following question: "What is the nature of the mixed question here and which kind of court (bankruptcy or appellate) is better suited to solve it?" The answer turns on "whether answering [the mixed question] entails primarily legal or factual work."

The Ninth Circuit utilizes a two-part test for non-statutory insider status: (1) whether the person's relationship with the debtor is similar to those of listed insiders; and (2) whether the relevant prior transaction was arm's-length. On the facts of the particular case at hand, the Court concluded that the issue could be reduced to whether a certain transaction was conducted at arm's-length, noting "[t]hat is about as factual sounding as any mixed question gets...[t]he court takes a raft of case-specific historical facts, considers them as a whole, balances them one against another—all to make a determination that when two particular persons entered into a particular transaction, they were (or were not) acting like strangers." The Court reasoned that "just to describe the inquiry is to indicate where it (primarily) belongs: in the court that has presided over the presentation of evidence ... and that has both the closest and deepest understanding of the record—*i.e.*, the bankruptcy court."

The Court then reexamined the issue by stating how little *legal* work was required in applying the Ninth Circuit test and determined that even if the issue were reviewed *de novo*, it would be of little use to other courts resolving disputes. Because the nature of the question was, in essence, a factual inquiry, the Ninth Circuit correctly held that the bankruptcy court determination is subject only to review for clear error.

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