No. 10-232

In the Supreme Court of the United States

THE BANK OF NEW YORK MELLON AND
THE BANK OF NEW YORK MELLON CORPORATION,
Petitioners,

v.

FREDERICK J. GREDE, AS TRUSTEE OF THE
SENTINEL LIQUIDATION TRUST,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY BRIEF FOR PETITIONERS

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As the petition demonstrates, the Seventh Circuit's ruling conflicts with *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), deepens a circuit split over the scope of trustee litigation authority, and risks immense harm to the bankruptcy process. Grede offers no valid reason why the petition should not be granted.

1. Grede repeatedly contends that the question presented—whether a trustee appointed by a bankruptcy court to liquidate the estate has standing to sue third parties where any recovery will not go to the estate—is governed by *Sprint Communications Co.* v. *APCC Services, Inc.*, 128 S. Ct. 2531 (2008). But *Sprint* addresses a completely different question—whether an assignee has standing to sue where the proceeds will be passed on to the assignors. The issue here is not whether the proceeds will go to the assignors or the assignee, but whether they will go the estate.

That is the precise question addressed by this Court in *Caplin*. *Caplin* held that a trustee lacks authority to bring such suits, Congress reaffirmed the *Caplin* rule when it enacted the Bankruptcy Code in 1978, and the Ninth Circuit in *Williams* v. *California 1st Bank*, 859 F.2d 664 (9th Cir. 1988), held that the *Caplin* rule is not ousted merely because a liquidation trustee holds assigned claims. Grede's contention that *Sprint* limits *Caplin* and overrules *Williams* finds no support in *Sprint* (which does not address bankruptcy law, trustees, or estates) or in any court decision or secondary authority. Indeed, this Court in *Sprint* made clear that it was making no "change" to "history and precedent." 128 S. Ct. at 2536 (quoted at Opp. 13). That unchanged precedent must include *Caplin*.

2. Grede attempts to distinguish *Caplin* by contending that it has no application after a plan has been confirmed. But the liquidation trust established by the Plan here was simply a mechanism to liquidate the estate. Grede acknowledges (at 14) that if the bankruptcy court had administered the liquidation, the bankruptcy trustee would lack standing to bring a suit of this sort. There is no valid reason why the court's delegation of that task to a trust would abrogate the *Caplin* limit on trustee litigation authority. The Plan provided that "the Chapter 11 Case will remain open pending final order of the Bankruptcy Court closing the case and the Bankruptcy Court ***shall retain jurisdiction*** * * * to determine on a non-exclusive basis, any and all Causes of Action and Non-Estate Claims that have been transferred to the Litigation Trust." C.A. App. 104 § 9.1(b) (emphasis added). Thus, Grede as liquidation trustee continues to function under the oversight of the bankruptcy court and is not emancipated from the strictures of *Caplin*.

3. Grede offers no statutory support for his view that bankruptcy-court-appointed trustees may pursue litigation that will not benefit the estate. Yet it was the absence of such statutory support that led this Court in *Caplin* to conclude that trustees have no such authority. Grede attempts to limit the force of *Caplin* by suggesting (at 11) that it was construing the "now-repealed" Bankruptcy Act. But as Grede acknowledges (at 12), Congress expressly rejected a proposal to overrule *Caplin* and expand trustee litigation authority when it adopted the Bankruptcy Code in 1978. Congress thereby ensured that trustee litigation authority would continue to be limited to actions designed to benefit the estate. Although Grede (at 13-14) is correct that 11 U.S.C. § 704(a)(1)

does not expressly apply to Chapter 11 reorganizations, it is undeniable that a liquidating trustee has the duty to "collect and reduce to money the property of the estate," as § 704(a)(1) provides.

4. Grede asserts (at 15) that there is "no Circuit split" on the question presented. But the Seventh Circuit expressly noted that its ruling conflicts with the Ninth Circuit's decision in *Williams* and deepens an existing circuit split: "We must choose between the second circuit's holding and the ninth's." Pet. App. 5a. The Seventh Circuit sided with the Second Circuit against the Ninth Circuit, deepening a conflict that Grede cannot heal by speculating (at 16) that the Ninth Circuit today "likely would conclude [that] *Williams* is no longer good law." The Ninth Circuit has said nothing to undermine its *Williams* holding, and courts continue to cite it favorably. *E.g.*, *In re Bradley*, 326 F. App'x 838, 839 (5th Cir. 2009); *Charles Schwab & Co.* v. *Reaves*, 2010 WL 447370, at *4 (D. Ariz. Feb. 4, 2010).

Grede (at 16-17) attempts to distinguish two such cases cited in the petition, *Trenwick Am. Litig. Trust* v. *Ernst & Young, L.L.P.*, 906 A.2d 168 (Del. Ch. 2006), aff'd sub nom. *Trenwick Am. Litig. Trust* v. *Billett*, 931 A.2d 438 (Del. 2007), and *Mukamal* v. *Bakes*, 383 B.R. 798 (S.D. Fla. 2007), aff'd on other grounds, 2010 WL 1731775 (11th Cir. Apr. 30, 2010). But Grede disregards the *Trenwick* court's plain statement that "[t]he rule articulated in *Caplin* holds true even in cases where a creditor has assigned her claims to a trustee or Trust" (906 A.2d at 191), as well as the *Mukamal* court's conclusion that a post-confirmation liquidation trustee would lack standing to pursue assigned claims.

Grede suggests (at 17) that the *Mukamal* court's ruling would have been different "if all creditor claims" had been assigned to the trustee. But in that very different situation (not found in *Mukamal* or in this case), all estate creditors would share in the recovery and the *Caplin* issue would not arise. Grede (at 16) also derides both *Mukamal* and *Trenwick* as "not federal Court of Appeals decisions." But *Trenwick* was affirmed by Delaware's highest court, and *Mukamal* was affirmed by the Eleventh Circuit. Although the Eleventh Circuit's affirmance was based on other grounds, the court of appeals did not question the district court's view that the *Caplin* rule applies to a post-confirmation liquidation trustee holding assigned claims. See 2010 WL 1731775. These rulings exemplify the breadth of the division in the courts on the scope of the *Caplin* rule, confirming the need for this Court's review.

5. Grede contends (at 18-19) that the petition raises no important federal question because abrogation of the *Caplin* rule on trustee standing in this context does not risk practical harm to the bankruptcy process. But Grede does not contest that the ruling below allows *Caplin* to be circumvented by a mere formalistic recharacterization from bankruptcy trustee to liquidation trustee. Nor does he contest that this mere switch of hats lets the trustee draw freely on estate assets to pursue litigation that will not benefit the estate but only a subset of assigning creditors (and the trustee himself). Grede offers no statutory or policy defense for such forced litigation financing.

Instead, Grede argues (at 19) that application of the *Caplin* rule in this recurring context "would deprive bankruptcy estates from the benefits that post-

bankruptcy trusts create." That is not true at all. The Bank does not contest the use of liquidation trusts as a mechanism to liquidate estates, nor does it seek an "outright ban" on assignments to such trusts as Grede asserts (*ibid.*). The Bank contests only the authority of liquidation trustees to use estate assets to sue for recoveries that will not benefit the estate.

The Court in *Caplin* recognized the problems that such suits would generate, and Congress did as well when it refused to derogate from the *Caplin* rule in 1978. Grede's suggestion (*ibid.*) that Rule 11 and other protections against frivolous lawsuits would obviate these concerns is itself frivolous. *Caplin* did not address the merits of trustee lawsuits but rather the trustee's lack of statutory authority to file non-estate lawsuits and the conflicts and perverse incentives they would generate. As Judge Diane Wood has noted, a trustee's obligation to act "on behalf of the estate or the creditors as a whole" means that she "obviously may not roam around collecting whatever property suits her fancy." *Fisher* v. *Apostolou*, 155 F.3d 876, 880 (7th Cir. 1998). Yet that is the upshot of the ruling below, contrary to Congress's policy decisions to limit the litigation authority of trustees and to reject proposals to expand that authority.

Grede also argues (at 18) that estate creditors can prevent any harm from forced financing of litigation that will not benefit the estate by voting against or objecting to a plan that "does not repay their claims in full." But as in this case, creditors often have no idea what lawsuits a trustee may bring post-confirmation. Here, creditors had no reason to believe that Grede would not adhere to his legal responsibility to seek recoveries only for the estate (or Liquidation Trust). The remote possibility that

Grede might depart from that responsibility and bring suit where he would lack standing was far too hypothetical to sustain an objection or provide a reason to vote against the Plan. See *Holywell Corp.* v. *Smith*, 503 U.S. 47, 58 (1992) (rejecting contention that the United States, a creditor, "should have objected to the plan if it had wanted a different result" where the obligation of the trustee to file tax returns did not arise until after confirmation of the plan). Indeed, when confirmation of the Plan was being considered, the Trustee had already filed claims against the Bank in a prior lawsuit on behalf of the estate, and creditors had no reason to expect that the Trustee would file yet another action based on the same allegations.

6. For the same reason, Grede's preclusion argument (at 20-21)) is misplaced. Grede contends that the Bank's failure to object to the Plan's provision for assigning creditor claims to the Liquidation Trust precluded it from objecting to standing when this case was filed. But the issue here is not assignment but standing, which was not an issue before this case was filed well after confirmation of the Plan. Bankruptcy courts cannot decide issues "at a stage when they are not directly in issue and neither party has a full incentive to litigate them." *Brown* v. *Felsen*, 442 U.S. 127, 134 (1979). Standing cannot be addressed before a concrete case arises, and attempting to do so on a hypothetical basis would simply hamper the confirmation process and drain even more assets from the debtor's estate. As the district court explained, "[i]t is difficult to see how the issue of standing in this adversarial action could have been litigated as part of the less-formal confirmation process before the adversarial action itself was even filed." Pet. App. 13a.

Grede can obtain no support for his preclusion argument from *United Student Aid Funds, Inc.* v. *Espinosa*, 130 S. Ct. 1367 (2010). That case does not address whether a trustee's standing to bring a post-confirmation lawsuit must be determined prior to confirmation to avoid preclusion. In fact, it addresses only the narrow question of "whether an order that confirms the discharge of a student loan debt in the absence of an undue hardship finding or an adversary proceeding, or both, is a void judgment for Rule 60(b)(4) purposes." *Id.* at 1373. As with *Sprint*, Grede again relies on a case that does not answer the question presented.

7. In sum, Grede offers no viable reason for denying the petition. Mounting bankruptcies and the use of post-confirmation liquidation trusts have created incentives for trustee-initiated litigation that exceeds the limits prescribed by Congress and this Court. The ruling below gives judicial imprimatur to these unauthorized suits, risking great harm to the bankruptcy process and severe burdens on the federal judiciary. As this Court said in *Caplin*, the scope of trustee litigation authority is an important policy question best left to Congress.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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