No. 16-317

IN THE

Supreme Court of the United States

DEUTSCHE BANK TRUST COMPANY AMERICAS, ET AL.,

Petitioners,

v.

ROBERT R. MCCORMICK FOUNDATION, ET AL.,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

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REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

Respondents do not dispute that the courts of appeals are sharply divided over the question whether Section 546(e) applies to conduits. See Pet. 19-28. They just contend that the question was resolved by a 2006 amendment to the provision. But the Seventh Circuit's decision in *FTI Consulting, Inc.* v. *Merit Management Group, LP*, 830 F.3d 690 (7th Cir. 2016)—issued *after* that revision—correctly rejects respondents' arguments and in any event makes this Court's review even more urgent.

Respondents do not even *defend* the proposition that the presumption against preemption is inapplicable in the bankruptcy context. See Pet. 12-19. Instead, they argue that the Second Circuit never adopted that proposition. But the Second Circuit expressly stated that the "Bankruptcy Code constitutes a wholesale preemption of state laws regarding creditors' rights." Pet. App. 22a. Respondents cannot hide from that holding, which creates a clear circuit split.

Finally, respondents contend that the Second Circuit's holding that Section 546(e) preempts state-law fraudulent-conveyance actions by creditors does not conflict with any other appellate decision. See Pet. 28-37. But respondents miss the point, which is that the Second Circuit's controversial decision conflicts with *this* Court's precedents regarding the interpretation of the Bankruptcy Code. This Court should resolve the conflicts created by the decision below.

I. The Courts Of Appeals Are Divided On Whether Section 546(e) Applies To Conduits

Respondents concede that there is a circuit split regarding the scope of Section 546(e). Four circuits, including the Second Circuit, have held that the safe harbor protects transfers that are conducted *through* financial institutions (or other named entities).[1] The Seventh and Eleventh Circuits, however, have held that the safe harbor does not apply unless the financial institution is the debtor or transferee (or otherwise acquires a beneficial interest in the funds).

According to respondents, however, Congress's 2006 amendment of Section 546(e) dulls the circuit split of its bite. Thus, they say, the Eleventh Circuit's decision in *In re Munford, Inc.*, 98 F.3d 604 (11th Cir. 1996), is *too old*: It should be discounted because it came ten years before the 2006 amendment "correct[ed]" the Eleventh Circuit's decision. Br. in Opp. 24. But, they continue, the Seventh Circuit's decision in *FTI Consulting* should also be discounted because it's *too new*: It is "the first circuit in twenty years" to conclude that Section 546(e) does not apply to conduits, and so "[m]ore time is needed to allow the circuit courts to examine the issue." Br. in Opp. 25, 26.

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[1] Respondents cite *Kaiser Steel Corp.* v. *Charles Schwab & Co.*, 913 F.2d 846 (10th Cir. 1990), as another decision on their side of the split. Br. in Opp. 23-24. But that case did "not reach the conduit question." 913 F.2d at 848. And in *In re Kaiser Steel Corp.*, 952 F.2d 1230, 1240 (10th Cir. 1991), the challenged transfers were made *by* financial institutions and to beneficial shareholders. Regardless, the circuit split is entrenched and merits this Court's review.

Respondents' argument that the circuit split does not merit review because it is both too stale *and* too fresh is no reason to deny review. To the contrary, the longstanding circuit split persists even *after* Congress supposedly addressed the issue. That makes the need for this Court's review greater than ever.

Indeed, in *FTI Consulting*, the Seventh Circuit expressly rejected the contention—advanced by respondents here—that "Congress would have jettisoned *Munford*'s rule by such a subtle and circuitous route." 830 F.3d at 697. "If Congress had wanted to say that acting as a conduit for a transaction between non-named entities is enough to qualify for the safe harbor," the court explained, "it would have been easy to do that. But it did not." *Ibid.*

Respondents contend that *FTI Consulting* is distinguishable because the Seventh Circuit "had no occasion to consider the actual systemic risk occasioned by its decision." Br. in Opp. 26. Not so. The Seventh Circuit expressly acknowledged that "the safe harbor's purpose is to protect[] the market from systemic risk." 830 F.3d at 696 (internal quotation marks omitted). It just explained that there is no such risk when financial institutions act only "in their capacity as intermediaries." *Ibid.*

Respondents nevertheless suggest that the question presented is not worthy of review because this is not an "important recurring issue." Br. in Opp. 26. As respondents themselves have stated, however, "the Tribune litigation is no aberration," as "parties have begun in the last few years to adopt the same stratagem as in Tribune, purporting to have

the creditors (or their assignee), not the bankruptcy trustee," bring the claims. C.A. Dkt. 145 at 66-67. Many of those cases will necessarily implicate the "conduit" issue, because challenged transfers often pass *through* a financial institution.[2]

Finally, respondents contend that the decision below was correct. For example, they say that *Munford* and *FTI Consulting* effectively re-wrote the statute's text to limit challenges only to transfers "made by or to a qualifying entity *if that entity is the beneficial holder of the transferred property*." Br. in Opp. 28. But that is not what those cases held. Rather, those cases interpreted the "*by or to*" language and held that that language means that, to fall within the safe harbor, the transfer must be "by or to"—not *through*—a named entity.

And that makes complete sense. In determining the applicability of Section 546(e), the key question is *what transfer* the trustee seeks to avoid. If the trustee seeks to recoup money *from a financial institution*, then that is a transfer from the debtor "to" a named entity—and Section 546(e) would apply. But, if the trustee—like Petitioners here—seeks to recoup money from a creditor that is not a named entity, then that is a transfer from the debtor "to" the creditor—and it does not matter that the transfer happened to pass *through* a financial institution.

As the Seventh Circuit recognized, moreover, the purposes of the safe harbor are not served by respondents' expansive reading. Congress enacted

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[2] Of course, the "conduit" issue is not always *argued* in such cases because Second Circuit precedent squarely forecloses it.

the provision "to prevent one large bankruptcy from rippling through the securities industry." *FTI Consulting*, 830 F.3d at 696 (internal quotation marks omitted). That systemic risk is implicated when the trustee seeks to recover funds from a financial institution (which could go bankrupt as a result). But it is not implicated where the trustee seeks to recover funds from shareholders that are *not* named entities. The Second Circuit's interpretation creates a massive windfall for transferees who are shielded from liability because they received a fraudulent transfer that just happened to pass *through* a financial institution.

II. The Second Circuit Held That The Presumption Against Preemption Is Inapplicable In Bankruptcy Cases

The Second Circuit's holding that the presumption against preemption does *not* apply in bankruptcy cases creates a circuit split and conflicts with this Court's decisions on an important recurring issue.

Respondents downplay that conflict by running away from the decision below. According to respondents, the Second Circuit "never said that" the presumption does not apply in the bankruptcy context. Br. in Opp. 10. Rather, they say, the court held only that the presumption does not apply to the *specific issue* raised by this case—whether Section 546(e) "preempts state-law fraudulent-conveyance claims to unwind a transaction that occurred in the national securities markets involving a debtor in federal bankruptcy proceedings." Br. in Opp. 12.

The Second Circuit's holding was not so limited. Before turning to the circumstances of this case, the

court observed that the presumption against preemption applies where a regulatory area is "traditionally the domain of state law." Pet. App. 20a (internal quotation marks omitted). But, the court continued, "the regulation of creditors' rights has a history of significant federal presence." Pet. App. 21a (internal quotation marks omitted). In support, the court noted that Congress's power to make bankruptcy laws was "made explicit" in the Constitution; that "detailed, preemptive federal regulation of creditors' rights has, therefore, existed for over two centuries"; and that "[t]he United States Bankruptcy Code provides a comprehensive federal system of penalties and protections to govern the orderly conduct of debtors' affairs and creditors' rights." Pet. App. 22a (internal quotation marks omitted).

Thus, the Second Circuit concluded, "[o]nce a party enters bankruptcy, the Bankruptcy Code constitutes a *wholesale preemption* of state laws regarding creditors' rights." Pet. App. 22a (emphasis added). Yet Respondents do not even cite that language—which suggests that the Second Circuit created a presumption *of* preemption in the bankruptcy context.

Respondents likewise contend that the decisions from the Third and Ninth Circuits "simply reflect the different federal and state interests implicated by the statutory provisions at issue in each case." Br. in Opp. 14. Again, however, that assertion is squarely at odds with the decisions themselves.

In *Integrated Solutions, Inc.* v. *Service Support Specialties, Inc.*, 124 F.3d 487 (3d Cir. 1997), the Third Circuit stated that, in preemption cases, "*any analysis* should begin with the basic assumption that

Congress did not intend to displace state law." *Id.* at 491 (emphasis added). The court then rejected the argument that the Code preempted state-law restrictions on the transfer of estate property—a proposition "rendered wholly unconvincing, especially in light of our strong presumption against inferring Congressional preemption *in the bankruptcy context*." *Id.* at 493 (emphasis added). The court could scarcely have made it clearer that it was talking about "the bankruptcy context" writ large, not just a specific *provision* of the Code.

The same goes for the Ninth Circuit's decision in *Pacific Gas & Electric Co.* v. *California ex rel. California Department of Toxic Substances Control*, 350 F.3d 932 (9th Cir. 2003). There, the Ninth Circuit explained that "the presumption against displacing state law by federal bankruptcy law is *just as strong in bankruptcy* as in other areas of federal legislative power." *Id.* at 943. (emphasis added). And it reached that conclusion even though "bankruptcy is one of only two federal legislative powers" where the Constitution "made explicit" that Congress has the power to make uniform laws. *Ibid.* The Second Circuit relied on that same "explicit" constitutional grant in support of its conclusion that the presumption does *not* apply in the bankruptcy context. The circuit split is real.

Respondents' efforts to distinguish this Court's cases applying the presumption in bankruptcy cases fail for the same reason. In *Midlantic National Bank* v. *New Jersey Department of Environmental Protection*, 474 U.S. 494, 505 (1986), for example, this Court held that "Congress did not intend for the Bankruptcy Code to pre-empt all state laws." The

Second Circuit's holding that the Code constitutes "a wholesale preemption of state laws" (Pet. App. 22a) is irreconcilable.

Respondents' last resort is to argue that, split or not, the presumption against preemption "does not determine the outcome of the case" because "petitioners' state-law claims plainly conflict with the objectives behind § 546(e)." Br. in Opp. 15. But that just assumes the conclusion—specifically, that the "objectives" that the Second Circuit believed Congress sought to advance are more important than the words Congress used to advance them. Courts other than the Second Circuit have disagreed. See Pet. 35. As we show below, the Second Circuit's assumption is wrong. In any event, that is a determination that should be made *in light of* the presumption against preemption, not *instead* of applying that bedrock principle.

III. The Second Circuit's Implied-Preemption Holding Conflicts With This Court's Precedents

The Second Circuit held that Section 546(e) preempts state-law fraudulent-transfer claims by creditors. Respondents contend that, in challenging that decision, we fault the Second Circuit for neglecting to "give appropriate consideration to the Bankruptcy Code's goal of maximizing assets available to creditors," which we believe was Congress's "overriding goal" in enacting Section 546(e). Br. in Opp. 21-22.

But that is not our position. Our position is that in enacting Section 546(e) Congress balanced "the multiple policies served by the Code." Pet. 29.

Consequently, this Court has held, "it is not for courts to alter the balance struck by the statute." *Law* v. *Siegel*, 134 S. Ct. 1188, 1198 (2014). Rather, courts must give effect to the balance struck by *Congress* in pursuing its goals—a balance that is reflected in the Code's "plain language, context, and structure." *Hall* v. *United States*, 132 S. Ct. 1882, 1893 (2012).

The Second Circuit did just the opposite. It began with what it perceived to be the central *policies* animating Section 546(e). Based on those policies, and not the statute's text, the court held that Section 546(e)—which bars fraudulent-conveyance actions by "the *trustee*"—impliedly preempts fraudulent-conveyance claims by *creditors*. The Second Circuit's analysis conflicts with this Court's precedents regarding the interpretation of the Bankruptcy Code.

Respondents protest that the Second Circuit *did* give effect to Section 546(e)'s text. Specifically, they contend that "trustee" *actually means* "creditors." That is because, they say, there is an "identity in bankruptcy between creditors and their representative." Br. in Opp. 16.

But there is no such "identity" between creditors and the trustee—and respondents do not point to any Code provision or decision saying so.[3] To the

[3] There *is* a "virtual identity of function between a trustee and a *debtor in possession*." *Zilkha Energy Co.* v. *Leighton*, 920 F.2d 1520, 1524 (10th Cir. 1990) (emphasis added). Thus, under the Code, "a trustee or debtor-in-possession is empowered to bring an avoidance action," and Section 546(e)'s safe harbor likewise applies to claims "brought by a trustee or a debtor-in-

contrary, other provisions of the Code expressly refer to "any creditor" when Congress meant to include creditors. See Pet. 32. If Congress had intended Section 546(e) to apply to creditors, too, "it could simply have said so." *Hartford Underwriters Ins. Co.* v. *Union Planters Bank, N.A.*, 530 U.S. 1, 7 (2000). It didn't.

Respondents' answer is that, "[h]aving given only the trustee the power to avoid, Congress had only to limit the avoidance power of 'the trustee' in the safe harbor." Br. in Opp. 16-17 n.8. But that just proves our point. Precisely *because* Congress gave only the trustee avoidance powers, Section 546(e)—an exception to those powers—necessarily applies only to the trustee, and not to parties that Congress never empowered in the first place. Creditors' power to bring fraudulent-conveyance claims comes from state law, not Congress, and the *question presented* is whether Congress preemptively *took away* that power without saying so.

As we also explained (at 32-33), a neighboring Code provision expressly preempts certain state-law claims. 11 U.S.C. § 544(b)(2). The fact that Congress chose *not* to include such a preemption provision in Section 546(e) "is powerful evidence that Congress did not intend" the safe harbor to preempt state-law claims belonging to individual creditors. *Wyeth* v. *Levine*, 555 U.S. 555, 575 (2009).

Respondents' only response is that "[t]he court below rejected that argument." Br. in Opp. 22 n.9.

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possession." *PHP Liquidating, LLC* v. *Robbins*, 291 B.R. 603, 606-07 (D. Del. 2003).

But that is no answer. Our argument is that the court below *wrongly* rejected that argument. Respondents say nothing to defend the flawed reasoning below.

Respondents also note (at 9 & n.5) that the Second Circuit's implied-preemption holding conflicts only with three trial-court decisions. But the conflict meriting review goes beyond Section 546(e). The Second Circuit's *analysis* is at odds with this Court's precedents holding that, in bankruptcy cases, the court's role is *not* to determine Congress's policy in enacting a provision, but rather to determine how far a provision goes in the service of the multiple provisions of the Code. And that requires a court to start with the statute's text, not its perceived purpose. Pet. 29.

So respondents have a backup. From its very first page, their brief is replete with assertions that the trustee has the "exclusive" right to bring fraudulent-conveyance actions. Thus, they say, "petitioners' theory assumes that their state-law claims revert to creditors after being vested" exclusively in the trustee. Br. in Opp. 17.

Once again, respondents mischaracterize our position. We did not argue that creditors' state-law claims "revert" to creditors after being "vested exclusively in the trustee." We argued the *opposite*: that "State-Law Fraudulent Conveyance Claims Are *Not* Property Of The Bankruptcy Estate That Must 'Revert' To Creditors." C.A. Dkt. 214 at 18 (emphasis added).

In any event, respondents' refrain that the trustee has the "exclusive" right to avoid fraudulent

transfers finds no basis in the Code. To be sure, the trustee has an exclusive right to bring such actions *during the automatic stay* of litigation created by Section 362. Once that stay expires or (as here) is lifted, however, the trustee's exclusive right expires with it—and creditors are free to bring suit themselves.[4]

At bottom, respondents' "reverter" argument is simply an effort to muddy the waters. The Second Circuit *rejected* respondents' argument that the creditors here lacked "standing" to bring their state-law claims (Pet. App. 15a-18a). Instead, the court held that those claims are preempted by Section 546(e)—even though the provision refers only to claims by "the trustee." The court of appeals' analysis conflicts with this Court's precedents—and with the text, structure, and context of the statute.

CONCLUSION

For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari should be granted.

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[4] Citing a pair of Supreme Court decisions from 1878 and 1880, respondents assert that all creditors' remedies are "'absorbed" into those of the trustee. Br. in Opp. 18 (quoting *Glenny* v. *Langdon*, 98 U.S. 20, 28 (1878)). But those decisions were based on a "vesting" provision in the Bankruptcy Act of 1867 that Congress *deleted* when it enacted the Bankruptcy Code of 1978. Section 541(a)(1)—the current provision—provides that the bankruptcy estate comprises "all legal or equitable interests of the debtor in property as of the commencement of the case." Because state-law fraudulent-conveyance claims are *not* the property of the debtor, such claims never became "property of the estate" in the first place. The trustee's claims are not exclusive, and they need not "revert" to creditors.

Respectfully submitted.

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