No. 21-109

In The Supreme Court of the United States

CALIFORNIA STATE LANDS COMMISSION,

Petitioner,

v.

EUGENE DAVIS, in his capacity as Liquidating Trustee of the Venoco Liquidating Trust, and STATE OF CALIFORNIA,

Respondents.

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

REPLY BRIEF IN SUPPORT OF CERTIORARI

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INTRODUCTION

Respondent does nothing to dispute the fact that the Third Circuit's broad and legally unsupportable expansion of sovereign immunity will encompass a wide swath of claims against the States, far exceeding the limited category of claims at issue in *Central Virginia Community College v. Katz*, 564 U.S. 356 (2006) (*Katz*). The Third Circuit's standard of whether a non–Bankruptcy Code claim "furthers" an antecedent bankruptcy proceeding lacks support in the historical understanding of the Bankruptcy Clause as set out in *Katz*. Respondent instead relies on a misrepresentation of the record (including his own Complaint) and a feigned factual "complexity" that has little bearing on the discreet legal issues before this Court.

ARGUMENT

I. STATEMENTS IN RESPONDENT'S OPPOSITION CONTRADICT THE RECORD

1. The Adversary Proceeding is limited solely to claims for inverse condemnation. The Complaint in this case seeks only "inverse condemnation damages against the State of California . . . and the California State Lands Commission," JA 116, alleging only two causes of action, both seeking "just compensation" for Defendants "taking of the EOF," JA 128, 129.

2. The Adversary Proceeding did not include, and could not have included, a pre–Effective

Date claim.[1] Throughout his Opposition, Respondent asserts, without basis, that this case raises a pre–Effective Date application of *Katz*. Opp. 1, 16, 31. Respondent contends that the Commission owed unpaid "just compensation" for pre–Effective Date claims. Opp. 16. This contention, which Respondent raised for the first time in oral argument before the Third Circuit, is contradicted by the Complaint, which states: "Prior to October 15, 2018, and for the duration of these chapter 11 cases, Defendants have compensated Venoco for such use [of the EOF.]" JA 117 (Compl. ¶ 1).[2] Moreover, since the Commission was on the EOF by consent prior to the Effective Date, there could not be a claim for inverse condemnation. *See*, *e.g.*, *Kirby Lake Dev., Ltd. v. Clear Lake City Water Auth.*, 320 S.W.3d 829 (Tex. 2010); *see also* 8 Nichols on Eminent Domain § G14E.01 (2021) at n.6 (Matthew Bender, 3d ed.).

3. Respondent is not subject to meaningful Bankruptcy Court oversight. Respondent asserts that he is "accountable to the Bankruptcy Court and the beneficiaries of the Trust in several ways," yet he specifically references only "quarterly reports." Opp. at 6. These are cursory accounting reports mandated by the Office of the United States Trustee. Furthermore, Respondent acknowledged before the District Court

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[1] The Plan providing for the establishment of a liquidating trust (the "Liquidating Trust") had an effective date of October 1, 2018 (the "Effective Date").

[2] Moreover, the Commission submitted evidence of payment of all pre–Effective Date amounts due under the prior agreement. *See* Dkt. No. 56-1 in Case: 20-1061 (3d Cir.).

that he is entitled to sell property without seeking Bankruptcy Court approval. *See* JA 78.

II. THE DECISION BELOW WRONGLY EXPANDS *KATZ* BEYOND ITS RATIONALE.

1. The Adversary Proceeding is fundamentally different from *Katz*.

First, the proceeding in *Katz* was brought under the powers expressly granted by Code sections 547(b) and 550(a) "to marshal the entirety of the debtor's estate." 546 U.S. at 371-72. The Adversary Proceeding, by contrast, alleges state-law and constitutional claims entirely divorced from bankruptcy law. Specifically, the Complaint seeks "inverse condemnation damages" arising under California law and the Fifth Amendment's Takings Clause. As such, it does not present a claim arising under federal bankruptcy law, insolvency law, or a claim historically brought "as a core aspect of the administration of bankruptcy estates." 546 U.S. at 372.

Second, the avoidance and recovery of pre-bankruptcy preferential transfers at issue in *Katz* sought recovery of funds transferred *before* the bankruptcy petition was filed. 546 U.S. at 360. Here, Respondent's "inverse condemnation damages" claim relates to the period *after* the Effective Date of the Plan. JA 117, 126, 128-30. While Respondent contends that he seeks "just compensation" for a period prior to the Effective Date, Opp. 7, he does not allege that in the Complaint, and any amounts allegedly due under any prior agreement

are contractual and cannot give rise to inverse condemnation damages. *See* p. 2, *supra*. Respondent made this same contention (belatedly) at the Third Circuit oral argument, but that Court did not take the bait, stating, "[w]e do not need to decide whether the Adversary Proceeding only pertains to post-effective claims." Pet. 22a.

Third, the avoidance and recovery claim in *Katz* sought return of discrete and identifiable funds transferred immediately prior to bankruptcy. Here, Respondent seeks money payable directly from the California treasury, striking to the core of sovereign immunity. Such a claim is akin to the damages suit payable from a state treasury brought in *Chisholm v. Georgia*, 2 U.S. 419 (1793), which led to the Eleventh Amendment's passage. Respondent disputes the relevance of the fact that the Complaint seeks payment from a State for money damages.

For these reasons, the Adversary Proceeding is fundamentally different from the proceeding in *Katz*, and the application of its holding in this case has created a dramatic expansion of *Katz*'s previously "limited" abrogation of sovereign immunity.

2. The Third Circuit committed three fundamental errors in applying the *Katz* framework.

First, the Third Circuit's decision permitted abrogation of sovereign immunity regardless of the nature of the claim, so long as it was said to "further" an antecedent bankruptcy proceeding. Since essentially any claim with respect to property in a Liquidating Trust

could be said to "further" the bankruptcy proceeding by providing additional funds for payment of creditors, any such claim would fall within the bankruptcy court's *in rem* jurisdiction under the Third Circuit's reasoning, resulting, *ipso facto*, in the abrogation of sovereign immunity.

The transfer of the Debtors' property to the Liquidating Trust on the Plan's Effective Date was, however, a meaningful event. The decision below elides over its importance by relying upon case law holding that a bankruptcy court may retain post–Effective Date *jurisdiction* over a claim relating to property in the Liquidating Trust on the basis that the claim "furthers" or is "related to" the previous bankruptcy proceeding. As this Court has held twice, the fact that the Bankruptcy Code has vested bankruptcy courts with jurisdiction does not mean the exercise of that jurisdiction is consistent with Article III. *Stern v. Marshall*, 564 U.S. 462 (2011); *Northern Pipeline Constr. Co. v. Marathon Pipeline Co.*, 458 U.S. 50 (1982). Similarly, that a bankruptcy court may have jurisdiction over an action does not necessarily mean that sovereign immunity has been abrogated with respect to that action.

In *Katz*, this Court rejected the idea that all bankruptcy-related disputes can automatically defeat state sovereign immunity: "We do not mean to suggest that every law labeled a 'bankruptcy' law could, consistent with the Bankruptcy Clause, properly impinge upon state sovereign immunity." 546 U.S. at 378 n.15. The Commission urged the Third Circuit to engage in an analysis of whether the Adversary Proceeding was the

type of proceeding that the Framers would have understood to be a bankruptcy proceeding, but the court declined to do so, characterizing it as "a duplicative and unnecessary historical analysis." Pet. 21a.

Katz, however, *requires* that a court undertake that analysis, as it held that sovereign immunity was abrogated as to the proceedings at issue there because "those who crafted the Bankruptcy Clause would have understood it to give Congress the power to authorize courts to avoid preferential transfers and to recover transferred property," and "that authority has been a core aspect of the administration of bankrupt estates since at least the 18th Century." 546 U.S. at 372. Respondent's inverse condemnation claim shares neither of these characteristics. There is no basis for concluding that Respondent's claim would have been understood by the Framers to be comparable to a proceeding for the recovery of transferred property or to the granting of habeas corpus to a discharged debtor, much less that it would have been considered a "core aspect of the administration of bankrupt estates."

The Third Circuit's holding that sovereign immunity is abrogated with respect to the adjudication of an inverse condemnation claim because it "furthers" the bankruptcy court's jurisdiction is unanchored to any historical understanding of the Bankruptcy Clause. Instead, it is based on vague formulations as to whether the proceeding "facilitate[s] equitable distribution" of Trust property, Pet. 19a, and "seeks a ruling on rights" to Trust property. Pet. 18a, 29a. This broad and legally unsupportable expansion of sovereign immunity will

encompass a wide swath of claims against the States, far exceeding the limited category of claims this Court had before it in *Katz*.

Moreover, the Third Circuit made no effort to analyze whether Congress has *exercised* its power to abrogate state immunity for such claims. Section 106(a)(1)—which it never cites—states Congress' own judgment as to the limits it did *and did not* impose on the States' immunity. Significantly, section 541, which defines property of the estate, was drafted so as to bar state-law suits to augment estate assets from being covered by section 106's waiver of sovereign immunity. 140 Cong. Rec. H. 10766 (Oct. 4, 1994); H.R. Rep. No. 835, 103rd Cong., 2d Sess. 13-15 (1994).

Second, the Third Circuit attributed no significance to the Effective Date of the Plan and the resulting transfer of the Debtors' assets to the Liquidating Trust under the terms of the Plan. JA 498, 557 (Plan provisions providing for asset transfer). As a result, it held that abrogation of sovereign immunity takes place irrespective of when the claim arose, so long as a bankruptcy court concludes that a post–Effective Date proceeding "furthers" the previous bankruptcy proceeding.

Katz's discussion regarding the avoidance and recovery of pre-petition preferential transfers does not support the abrogation of sovereign immunity with respect to a state-law claim, such as here, that arose subsequent to a bankruptcy proceeding. Indeed, this Court's entire analysis in *Katz* was limited to

historically-recognized proceedings involving the marshaling and determination of rights to a debtor's assets or proceedings to enforce a discharge decree, *e.g.*, the issuance of habeas corpus for relief of a discharged debtor. *See*, *e.g.*, 546 U.S. at 373-79.

The Third Circuit's holding that immunity is abrogated as to any claim that "furthers" a bankruptcy proceeding eliminates two of the principal constraints on abrogation inherent in *Katz*—the time when the claim arose and the basis of the claim. The Third Circuit would have abrogation run with the property in the Liquidating Trust, akin to a land covenant. But a liquidating trust or other post–effective date successor entity tasked with selling or managing property for creditors could remain in existence for many years. *See*, *e.g.*, *In re Resorts, Intl., Inc.*, 372 F.3d 154 (3d Cir. 2004) (litigation trust created in 1990; trustee files suit in 1997); *Street v. End of the Rd. Tr.*, 386 B.R. 539 (D. Del. 2008) (liquidating trust created in 1998; trust sued in 2007). The Third Circuit thus extends the "limited" abrogation of sovereign immunity intended for "core aspects" of a bankruptcy proceeding to claims that might arise long after a bankruptcy plan has been substantially consummated.

The Third Circuit's holding also effectively hands control over when abrogation of sovereign immunity will be permitted to the debtor and its commercial creditors in each bankruptcy proceeding, since it is those parties that specify the degree of control that the bankruptcy court will have over a liquidating trustee or other successor in a Plan. Thus, not only is the scope

of abrogation not tied to *Katz*'s historically-based standard, it would be largely determined by the parties drafting the Plan.

Third, the Third Circuit was incorrect when it reasoned that "[i]f the California Parties could assert sovereign immunity in the Adversary Proceeding, they would have a win-win—able to recover from the Trust on account of their claims against Venoco while preventing any judicial scrutiny over whether they can use the [EOF] without payment." Opp. 14 (quoting Pet. 20a).

In fact, the Commission concedes that judicial scrutiny is available—just not in a federal court. Respondent's inverse condemnation claim *can*, of course, be brought against the Commission in the California courts. As the Commission repeatedly conceded below, most recently in its brief to the Third Circuit: "Appellants never argue that California law prohibits [Respondent] from bringing an inverse condemnation action. To the contrary, California law provides that actions for money damages can be brought against the State, so long as it is brought in the California courts." Commission Third Circuit Reply Br. at 31.

In other words, the Commission will not evade judicial scrutiny by reason of its invocation of sovereign immunity. The question, rather, is where that scrutiny will take place—in a Delaware federal court, far from the affected property and percipient witnesses, or in a California court, hearing local witness testifying about local property and applying California law.

Because the Third Circuit decision greatly expands the "limited" abrogation found in *Katz* to a fundamentally different proceeding and permits abrogation for essentially any post-confirmation claim regardless of its nature or when it arose so long as it can plausibly be described as "furthering" an antecedent bankruptcy proceeding, this case merits review to rein in expansion of *Katz* far beyond its stated terms to new classes of cases that threaten the core sovereignty of the States.

III. THIS COURT SHOULD RECONSIDER *KATZ*.

Respondent faults the Commission for not asking the lower courts to reconsider *Katz*. Opp. 25-26. Such a request would, of course, have been futile and unnecessary since lower courts have no power to overrule decisions of this Court.[3]

Respondent further argues that the standard necessary to overcome *stare decisis* has not been met. To the contrary, the reasons for reconsideration are present with regard to *Katz*. Its reasoning and historical basis have been contested from the outset, starting with the vigorous four-member dissent. 546 U.S. at 379

[3] Respondent also claims that the Commission's counsel "conceded" at oral argument below that *Katz* "probably is correct." Opp. at 26. Not so. Counsel made no statement concerning the correctness of *Katz*. Instead, he said that *Justice Kagan's description* of *Katz* in *Allen v. Cooper*, 140 S. Ct. 994 (2020) was probably correct, to which, Third Circuit Judge Ambro responded: "It's not probably correct; it has to be correct because they said it." *See* Dkt. No. 58-1 at 14:23-15:5 in Case No. 20-1062 (3d Cir.).

(Thomas, J.). The scholarly criticism of the reasoning and historical basis of *Katz* has continued, Pet. 25-30, in the face of little support in response.

Perhaps the most important reason supporting reconsideration is that *Katz* stands alone in sovereign immunity jurisprudence. This Court has acknowledged that it is a "good-for-one-clause-only holding." *Allen*, 140 S. Ct. at 1003. Not only is *Katz* unique because it found that the Bankruptcy Clause alone among the enumerated powers of Article I abrogates sovereign immunity, but additionally, as this Court observed, there was a "more striking aspect [of *Katz*], which further separates it from any other" sovereign immunity case—namely, its holding that the Bankruptcy Clause did not allow Congress to abrogate sovereign immunity, but rather, the Clause "itself did the abrogating." *Id*. at 1002-03. Inasmuch as debtors were generally viewed as quasi-criminals at the time, *see* Karen Cordry, *Seminole Seven Years On*, Norton's Annual Survey of Bankruptcy Law 383, 394-96 (2003), it is a particularly extraordinary claim that the States waived their immunity as to that singular clause, and such a claim should require extraordinary evidence. For the reasons set forth in the Petition, Pet. 25-30, that claim lacks sufficient evidence in the historical record.

IV. THIS CASE DOES NOT PRESENT VEHICLE PROBLEMS.

Respondent's attack on this case as a good vehicle for considering the questions presented lacks merit.

First, although Respondent contends this case has factual complexities, Opp. 31, the facts of this case are set forth briefly and cogently in the opinions below. In any event, since the existence of sovereign immunity is a threshold legal question, it is decided on the face of the Complaint prior to discovery. Proceedings in this case were stayed after the Bankruptcy Court decided sovereign immunity and no fact development whatsoever occurred.

Second, Respondent argues, with little explanation, that this case is "an outlier." Opp. 31. While the Commission contends that the Adversary Proceeding is fundamentally different from *Katz*, none of the lower courts considered this case sufficiently distinguishable that they did not view *Katz* as controlling law. Thus, whether this case is an "outlier" or not has no bearing on whether this case presents a good vehicle for decision.

Third, Respondent has tried mightily to create an issue of whether the Complaint presented an exclusively post–Effective Date claim. Opp. 15-16, 31. But, as shown above, Respondent's position has no merit, *see supra* at p. 2, and in any event the Third Circuit *assumed* that the Adversary Proceeding "only pertains to post–effective date claims" for purposes of its decision. Pet. 22a.

Lastly, Respondent contends that questions as to the applicability of *Katz* are not common, relying upon the only six court of appeals opinions that he contends "meaningfully engage" with *Katz*. Opp. 31-32.

Respondent, however, fails to mention the over 300 bankruptcy and district court cases that have referenced *Katz*. It is the bankruptcy and district courts which are routinely required to apply *Katz* and will benefit from this Court's guidance as to its appropriate scope.

CONCLUSION

For these reasons, the Commission respectfully requests that this Petition be granted.

Respectfully submitted,

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