No. 21-1322

In The

Supreme Court of the United States

JAN M. SENSENICH, CHAPTER 13 TRUSTEE,

Petitioner,

v.

PHH MORTGAGE CORPORATION,

Respondent.

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

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

A. The federal courts are deeply divided.

1. A deep circuit split exists about when appellate courts[1] may affirm bankruptcy sanctions orders on alternate correct grounds. Seven circuits allow affirmance on alternate correct grounds even if the bankruptcy sanctions order never mentions the ground-at-issue. Pet.22-25. The Second Circuit disagrees: bankruptcy sanctions orders "cannot" be affirmed on alternate correct grounds unless the order itself "assess[es] whether the sanction [is] authorized" under the ground-at-issue. Pet.App.23.

This split reflects two radically opposite views of bankruptcy sanctions orders. The seven circuits that comprise the 'majority rule' recognize these orders are "indivisible" judgments affirmable under any theory that supports the judgment. *Jennings v. Stephens*, 574 U.S. 271, 279, 282 (2015). So if a bankruptcy court imposes a fine under 28 U.S.C. §1927 that §1927 does not authorize, the appellate court may still affirm the fine on alternate correct grounds—even if the sanctions order does not discuss the ground-at-issue. The majority rule rejects "overturn[ing] the bankruptcy court's decision merely because that court applied the wrong label to [a] righteous use of its [power]." *Fellheimer, Eichen & Braverman, P.C. v. Charter Techs., Inc.*, 57 F.3d 1215, 1227 (3d Cir. 1995).

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[1] "Appellate courts" covers all courts that hear bankruptcy appeals, including district courts, bankruptcy appellate panels, and the federal courts of appeals. *See* 28 U.S.C. §158.

The Second Circuit views bankruptcy sanctions orders through a lens that "makes the opinion part of the judgment." *Jennings*, 574 U.S. at 282. This view "confine[s]" appellate jurisdiction to those grounds the bankruptcy court used "to support its sanctions order," which means an appellate court "[may] not consider potential alternative sources of authority." *In re Sanchez*, 941 F.3d 625, 626-27 (2d Cir. 2019). Under this strict rule, if a bankruptcy court imposes a fine under §1927 that §1927 does not authorize, then an appellate court must overturn the fine—end of story. The appellate court "cannot reach th[e] question" of whether alternate correct grounds support the fine because "the bankruptcy court simply did not exercise . . . [that] power." Pet.App.23 & n.2.

a. Respondent PHH Mortgage Corporation (PHH) spins the Second Circuit's outlier approach as mere concern for whether the bankruptcy sanctions order in this case was supported by sufficient findings. BIO.15-19. But as the panel majority here takes care to explain: "[t]he problem is not that the bankruptcy court's reasoning is too sparse." Pet.App.23 n.2. The panel majority furthers: "[o]ur role is to review what the bankruptcy court did," *id.*, and the "bankruptcy court analyzed . . . [its] sanction *under Rule 3002.1*." Pet.App.24 (italics-in-original). The panel majority thus determines that *no matter the findings below*, the panel "cannot reach th[e] question" of inherent power. Pet.App. 23.

PHH quotes the panel majority's statement that "the majority opinion does not limit a bankruptcy

court's inherent power to sanction offenders" if that court "make[s] sufficient findings." Pet.App.26; *see* BIO.19. This statement concerns the panel majority's *alternative holding*: that even if the bankruptcy court here had sufficiently discussed inherent power, the panel majority still could not affirm because the bankruptcy court made "no finding of bad faith." Pet.App.23. PHH's emphasis on the panel majority's "sufficient findings" statement then only reinforces the Trustee's second 'question presented': "[w]hether sanctions based on inherent judicial power always require a finding of bad faith." Pet.App.i.

b. PHH argues that the Second Circuit aligns with cases exemplifying the majority rule because these cases mention the need for sufficient findings. BIO.16-19. PHH misses the forest for the trees. PHH does not deny that in each majority-rule case (except *In re DeVille*[2]): (1) the bankruptcy court imposes a sanction on a wrong ground; and (2) the court of appeals holds that it may affirm the sanction on an alternate correct ground that the bankruptcy court did not assess. Pet.22-25. An undeniable split then exists between these cases and the Second Circuit, which holds that bankruptcy sanctions orders cannot be affirmed on an alternate correct ground when the order does "not assess" the ground. Pet.App.23.

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[2] In *In re DeVille*, the Ninth Circuit expressly "subscribe[s] to" the majority rule. 361 F.3d 539, 550 n.4 (9th Cir. 2013).

c. The Court recognizes the need to resolve circuit splits over the standards that govern appellate review of bankruptcy orders. A recent example is *U.S. Bank Nat'l Ass'n v. Village at Lakeridge*, 138 S. Ct. 960 (2018). The Court resolved whether "clear error (rather than *de novo*) [review]" applies to particular bankruptcy court findings. *Id.* at 965. This question divided a Ninth Circuit panel and created a 4-1 circuit split. *Id*.; Cert. Pet. 19-20, *U.S. Bank*, No. 15-1509 (U.S. Jun. 13, 2016). Here, the question of whether appellate courts may affirm bankruptcy sanctions orders on alternate correct grounds not discussed in the order divides a Second Circuit panel and creates a 7-1 circuit split.

2. A deep circuit split exists about whether inherent-power sanctions always require a bad-faith finding. Four circuits always require such a finding, while four others do not and the Second Circuit lacks consistency on the point. Pet.26-28. Multiple courts have called out this split. *See In re Charbono*, 790 F.3d 80, 87 n.3 (1st Cir. 2015); *First Bank of Marietta v. Hartford Underwriters Ins. Co.*, 307 F.3d 501, 520 (6th Cir. 2002) ("[O]ther Circuits have found that a specific finding of bad faith is not always required."); *United States v. Seltzer*, 227 F.3d 36, 41-42 (2d Cir. 2000) ("[T]here is a split. . . .").

a. PHH does not dispute that the circuits are split on whether inherent-power sanctions always require a bad-faith finding. BIO.19-23. PHH instead argues this split is "irrelevant" because when it comes to the bankruptcy sanctions order in this case, "all circuits would agree a bad faith finding is required." BIO.20.

But PHH cites no decisions to prove this is true in the First, Third, or Eighth Circuits—circuits that hold a bad-faith finding is not always required for reasons that cut against PHH (e.g., limiting bad-faith findings to fee awards). Put another way, PHH cites no decision from any of these circuits holding that a bad-faith finding must accompany an inherent-power fine against a sophisticated party like PHH who violates the same rule across multiple cases after a prior sanction and a broken promise of reform. Pet.App.29 (Bianco, J., dissenting) ("PHH's repeated violations").

b. PHH tries to pick apart the circuit decisions that declare inherent-power sanctions do not always require a bad-faith finding. BIO.20-23. PHH's efforts both fall short and prove the need for review.

Consider *In re Charbono*, 790 F.3d 80 (1st Cir. 2015). The First Circuit holds that when "an inherent-power sanction does not take the form of an award of attorneys' fees . . . [then] a finding of bad faith is not ordinarily required." *Id.* at 88. This rule conflicts with the panel majority's refusal here to affirm a $75,000 fine (not a fee award) as an inherent-power sanction because "there is no finding of bad faith." Pet.App.23. Or as *Charbono* puts it: "the absence of bad faith does not . . . undermine the inherent-power sanction imposed by the bankruptcy court." 790 F.3d at 88.

PHH responds that *Charbono* is a case about a debtor's "violation of a court order" and a "minor $100 sanction." BIO.20. But *Charbono*'s rule on bad-faith findings does not turn on either of these points—only

on whether the sanction in question is a fee award. PHH's bases for distinguishing *Charbono* also do not withstand scrutiny upon closer examination.

Charbono is not about violation of a court order but violation of a court rule (LBF 3015-1A) folded into a plan-confirmation order. *See* 790 F.3d at 84, 90. The rule imposed "a tax return production requirement" that was a "basic requirement[ ]" of the Chapter 13 process. *Id.* at 90 n.5. For this reason, the bankruptcy court penalized the debtor: "to send a message to the debtor and others regarding the importance of timely compliance." *Id.* at 90. The First Circuit then affirmed this inherent-power sanction with no indication that the outcome would be different if only the court rule (and no order) were involved. *See id.*

Charbono also is not about a "minor" sanction but a substantial sanction given the debtor's poverty. The debtor was in "dire straits" and "had a cash-flow problem." *Id.* So the bankruptcy court "halved the $200 sanction requested by the [t]rustee" and ordered the fine payable "more than three months after the date of the order." *Id.* The First Circuit subsequently lauded the bankruptcy court's "careful assessment" of the debtor's financial circumstances. *Id.*

PHH fares no better with the other circuits that share *Charbono*'s not-always-necessary view of bad-faith findings. PHH argues that the Eighth Circuit's "broad language" on this point in *Stevenson* does not matter because *Stevenson* "required a showing of bad faith" for a "monetary sanction." BIO.22. PHH omits that the "monetary sanction" was *a fee award*, placing

Stevenson in perfect alignment with *Charbono*'s rule that inherent-power sanctions do not require a bad-faith finding *except* for fee awards. *Stevenson v. Union Pac. R.R.*, 354 F.3d 739, 751 (8th Cir. 2004).

PHH similarly errs in suggesting that the Third Circuit has abandoned its view that "a court need not always find bad faith." *Republic of Philippines v. Westinghouse Elec. Corp.*, 43 F.3d 65, 74 n.11 (3d Cir. 1994); BIO.20-21. The Third Circuit has clarified that while inherent-power sanctions "usually" require a bad-faith finding, the Circuit is also "careful" to honor *Republic of Philippines*' conclusion that inherent-power sanctions "do not always require a showing of bad faith." *In re Prudential Ins. Co. Am. Sales Prac. Litig. Actions*, 278 F.3d 175, 181 n.4 (3d Cir. 2002).

PHH finally notes that the Ninth Circuit's lone example of when an inherent-power sanction does not require a bad-faith finding ("willful violation of a court order") fails to apply here. BIO.22. But this observation simply confirms the "confusion" that now pervades the circuits about inherent-power sanctions and bad-faith findings, leaving every circuit to draw the line in a different place—a reality that supports a grant of review. *Seltzer*, 227 F.3d at 41.

c. The Court recognizes the need to resolve circuit splits over the findings required to support a given sanction. In *Taggart v. Lorenzen*, 139 S. Ct. 1795 (2019), the Court resolved a circuit split over the findings required to penalize efforts to collect a discharged debt. *Id.* at 1799. And in *Goodyear Tire & Rubber Co. v.*

Haeger, 137 S. Ct. 1178 (2017), the Court resolved a circuit split over the findings required to award legal fees as a penalty for bad-faith conduct. *Id.* at 1185. Here, there is an undisputed circuit split over the findings required for an inherent-power sanction.

3. A stark federal-court split exists about whether Bankruptcy Rule 3002.1's authorization of "appropriate relief" for creditor violations of the rule includes punitive fines. Four bankruptcy courts have answered 'yes,' while the Second Circuit and one bankruptcy court have said 'no.' Pet.28-29.

PHH does not dispute the existence of this split. BIO.15. PHH argues this split does not merit review as "[n]o other circuit court or . . . district court has addressed th[e] issue" and "percolation" is needed. BIO.15. But all percolation means at this point is rulings like this: "[the] Court respectfully disagrees with the [Second Circuit] majority and agrees with the dissent." *Blanco v. Bayview Loan Servs., LLC*, 633 B.R. 714, 754 (Bankr. S.D. Tex. 2021).

B. The questions presented are critical.

1. The Trustee's 'questions presented' (or QPs) are critical as a matter of integrity, uniformity, and inequality. Pet.29-32. In terms of **integrity**, bankruptcy judges, trustees, and injured parties should not have to guess about the rules that govern bankruptcy sanctions orders at the risk of seeing "an appeal . . . wash away years of effort" to redress wrongful conduct. Pet.31. In terms of **uniformity**, parties should be able

to seek the same bankruptcy sanctions on the same terms no matter where in the nation a bankruptcy court is located. Pet.31-32. And in terms of **inequality**, bankruptcy judges deserve to see their sanctions orders treated with the same respect on appeal as those of district judges. Pet.32.

2. On the Trustee's first and second QPs, PHH replies that courts must exercise "caution in invoking [their] inherent power." BIO.24. PHH fails to explain how this point overcomes the integrity, uniformity, and inequality problems that exist because of circuit splits over how appellate courts review bankruptcy sanctions orders and whether all inherent-power sanctions require bad-faith findings. *Id.*

3. PHH maintains the Trustee's third QP is not critical because: (1) bankruptcy courts have "hummed along" without knowing for sure whether Rule 3002.1 allows fines; and (2) the "rule promulgation process" can address this issue. BIO.23-24.

a. PHH's "hummed along" claim blinks reality. "It is well documented that PHH (and its corporate affiliates) are serial violators of both Rule 3002.1 and the bankruptcy process in general." Bankr. Judges & Scholars Amici Br.9. Debtors and standing trustees, in turn, face steep hurdles in detecting and litigating Rule 3002.1 violations. "Most debtors simply do not have the personal resources to demand the production of a simple accounting for their [home] loans, ..." *In re Jones*, No. 03-16518, 2012 Bankr. LEXIS 1450 at *22 (Bankr. E.D. La. Apr. 5, 2012). And even

when debtors manage to identify Rule 3002.1 violations (e.g., improper fees), the amounts involved are often "small enough in relation to the burden and potential cost of litigation that the debtor just pays them." NACTT Amicus Br.12.

b. The rule promulgation process does not alter the importance of resolving whether Rule 3002.1 allows punitive fines (when proper). If the opposite were true, the Court would never grant review to address the proper interpretation of federal rules. Yet, time and again, the Court has granted such review. *See*, *e.g.*, *City of San Antonio v. Hotels.com*, 141 S. Ct. 1628 (2021) (addressing meaning of Fed. R. App. P. 39).

4. Being unable to diminish the importance of the Trustee's QPs, PHH accuses the Trustee of trying to turn Rule 3002.1 "into a tool . . . to fund . . . his office." BIO.2. In reality, the Trustee originally asked the bankruptcy court to award the fines at issue here to a nonprofit. *See In re Gravel*, 556 B.R. 561, 566 & n.1 (Bankr. Vt. 2016). PHH used this request against the Trustee, arguing on appeal that the Trustee could not defend the fines unless they were payable to him. *See* No.20-1 (2d Cir.), Doc.70 at JA.184. So, on remand, the Trustee asked the bankruptcy court to award the fines to him, ensuring his appellate rights. *Id.* The Trustee has no great desire to litigate sanctions or collect fines. He only seeks to ensure the protection of "debtors who cannot afford to dispute" PHH's kind of misconduct. *In re Gravel*, 556 B.R. at 579.

5. In the end, the Trustee's QPs are critical because they affect the ability of courts to "promptly and independently . . . administer public justice." *Gompers v. Bucks Stove & Range Co.*, 221 U.S. 418, 450 (1911). The long history of this case bears out the point. Without clarity on how bankruptcy sanctions work, even undisputed rule violations (as exist here) lack the possibility of prompt resolution.

C. This case is the right vehicle.

1. This case is the right vehicle to decide the questions presented because each question is a pure legal issue that is outcome-determinative; the facts relevant to each question are undisputed; and this case is fully ventilated. Pet.32-34.

2. PHH argues that this case is "riddled with contested issues"—for example, PHH's argument that $75,000 was not an "appropriate amount" for its Rule 3002.1 violations. BIO.25. Such issues do not impair this case's utility for resolving the Trustee's QPs. The Court often resolves foundational QPs and remands for resolution of leftover issues. *See*, *e.g.*, *Morgan v. Sundance, Inc.*, No. 21-328, slip op. at 7 (U.S. May 23, 2022) (rejecting "prejudice requirement" in a waiver inquiry and remanding to the Eighth Circuit to resolve the inquiry's proper "procedural framework").

3. PHH contends that disputed facts exist here. BIO.26. But as Judge Bianco makes clear (with no disagreement from the panel majority): in terms of

"PHH's repeated violations" of Rule 3002.1, the bankruptcy court's "findings as to these violations [were] not disputed on appeal." Pet.App.29.

4. PHH argues this case is not fully ventilated and cites various alternate grounds for affirmance. BIO.26-28. PHH does not deny, however, this case's full "analysis of every issue relevant" to the QPs. Pet.33. PHH also does not dispute the unrealistic nature of waiting for a better case given the extensive difficulty and costs of litigating matters like this. Pet.34.

D. The Court should issue a CVSG.

1. The Trustee and PHH unsurprisingly stand in full disagreement on the correctness of the Second Circuit's decision. In this regard, PHH casts itself as a mere sender of "informational mortgage statements that sought no fees, caused no harm, and violated no court orders." BIO.36. PHH omits that: (1) PHH's "informational" statements set forth misinformation, listing fees that "PHH admit[s] . . . [were] not . . . properly noticed . . . under Rule 3002.1," Pet.App.6; (2) PHH caused no harm "due to the diligence of the Trustee," Pet.App.27; and (3) violating Rule 3002.1 dozens of times in many cases is no less serious than violating a court order. NACTT Amici Br.4-7.

2. PHH spends much time trying to discredit Judge Bianco's dissent. BIO.28-35. PHH's tone-deaf analysis, however, only underscores Judge Bianco's overall point (which favors review): "the judicial branch and the public have a compelling interest in ensuring

that the bankruptcy process is not abused by Rule violations or other misconduct." Pet.App.47.

3. Should any doubts remain about the gravity of PHH's violations or the panel majority's erroneous resolution of this misconduct (including the questions presented), the Court should call for the views of the Solicitor General (CVSG). The Trustee proposed this in his petition, and PHH raises no objection. Pet.31. The United States also has vital interests at stake, given its Rule 3002.1 enforcement efforts. *Id.*

CONCLUSION

The Court should grant the Trustee's petition.

Respectfully submitted,

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