No. 23-1373

In the Supreme Court of the United States

CAPITAL CARTRIDGE, LLC, PETITIONER

v.

J. MICHAEL ISSA, AS TRUSTEE OF THE HMT LIQUIDATING TRUST

ROYAL METAL INDUSTRIES, INC., PETITIONER

v.

J. MICHAEL ISSA, AS TRUSTEE OF THE HMT LIQUIDATING TRUST

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR THE PETITIONERS

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A. There Is A Clear And Intractable Conflict Over A Significant Question Under The Bankruptcy Code

1. As the petition established (Pet. 9-22), this case presents an important question of federal bankruptcy law that has squarely divided the lower courts: when, if ever, can a creditors' committee invoke derivative standing to litigate avoidance claims under the Bankruptcy Code.

The 4-3 circuit conflict is undeniable and entrenched. Under the settled law of three circuits (the Third, Fifth, and Seventh), derivative standing is available "only" where the trustee "unjustifiably refuse[s]" to sue. *In re Consolidated Indus.*, 360 F.3d 712, 716-717 (7th Cir. 2004); see also *Torch Liquidating Trust ex rel. Bridge Assocs. LLC* v. *Stockstill*, 561 F.3d 377, 388 n.11 (5th Cir. 2009) (derivative standing allowed "*only*" when trustee "refused unjustifiably" to sue) (emphasis in original); *Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp.* v. *Chinery*, 330 F.3d 548, 561-562 (3d Cir. 2003) (same). But under the contrary law of four circuits (the Second, Sixth, Eighth, and Ninth), derivative standing is allowed whenever the trustee "consents"—the *opposite* of "refusing" to sue. *In re Smart World Techs., LLC*, 423 F.3d 166, 176 n.15 (2d Cir. 2005); see also *In re Blasingame*, 920 F.3d 384, 389 (6th Cir. 2019) (same); *In re Racing Services, Inc.*, 540 F.3d 892, 899, 902 (8th Cir. 2008) (same) (citing *Avalanche Maritime, Ltd.* v. *Parekh (In re Parmetex)*, 199 F.3d 1029, 1031 (9th Cir. 1999)); Pet. App. 4a, 46a-47a (same).

Nor do these circuits merely disagree over the end-result. In the "unjustified-refusal" camp, derivative standing is strictly cabined as a *limited* exception where "a trustee" shirks "her fiduciary duties" by refusing to litigate—that "narrow" circumstance alone justifies "equi-

tabl[y]" departing from the Code's text. *Weyandt* v. *Federal Home Loan Mortg. Corp. (In re Weyandt)*, 544 F. App'x 107, 110 (3d Cir. 2013) (authorizing "derivative" standing via "equitable powers" "when the Bankruptcy Code's envisioned scheme breaks down"); see also *In re Perkins*, 902 F.2d 1254, 1258 (7th Cir. 1990) (trustees lose "exclusive authority only in narrow circumstances"). "Otherwise," per these circuits, "there would be no reason" "to subvert the Bankruptcy Code[]" and assign a committee "powers normally granted exclusively to the Trustee." *Weyandt*, 544 F. App'x at 110.

By contrast, the other four circuits (including the Ninth Circuit) have broadly "expanded" the doctrine to include "consent"-based derivative standing—apparently as a matter of judge-made policy. See, *e.g.*, *Commodore Int'l Ltd.* v. *Ali (In re Commodore Int'l Ltd.)*, 262 F.3d 96, 99 (2d Cir. 2001) (describing the ability to "'coordinate litigation responsibilities'" as an "'effective method'" of "'manag[ing] the estate'"); *Racing Services*, 540 F.3d at 902 (endorsing consent-based standing as "'a reasoned and practicable division of labor'"). Although both sides effectively rewrite the Code, at least the former treats derivative standing as "the exception rather than the rule." *In re Baltimore Emergency Servs. II, Corp.*, 432 F.3d 557, 562 (4th Cir. 2005).

And the conflict further deepens with still a third camp refusing to permit derivative standing at all. The Tenth Circuit BAP categorically rejected the doctrine (*United Phosphorous, Ltd.* v. *Fox (In re Fox)*, 305 B.R. 912, 914 (B.A.P. 10th Cir. 2004)); the Fourth Circuit refused to embrace it (in a decision deemed "hostil[e]" to derivative standing, *Racing Services*, 540 F.3d at 898 n.7); the Third Circuit sharply divided en banc—with an emphatic four-judge dissent (including then-Judge Alito) declaring it lawless on every level; multiple lower courts denounce it;

and prominent academics and experts repudiate it as flawed and atextual. Pet. 18-21 (so explaining); see, *e.g.*, *Racing Services*, 540 F.3d at 898 n.7 (recognizing conflicting views); *Baltimore Emergency*, 432 F.3d at 561 (declaring derivative standing "far from self-evident"; "[s]trong arguments exist on both sides of the debate").[1]

At bottom, the conflict is widespread, mature, and entrenched. It has split seven circuits (plus one BAP) nearly down the middle. The Ninth Circuit cemented its "longstanding" position below (Opp. 2), and other circuits have applied their own contrary precedent for decades. There is no benefit to delay, and further percolation is pointless: neither side has indicated any willingness to back down, and it would take multiple circuits flipping sides to eliminate the stark conflict. In the meantime, courts and parties continue wasting endless time and resources debating the question—and fighting over judge-made tests for (atextual) derivative standing.

The ability of a creditor's committee to litigate some of the most important matters in a bankruptcy case should not be determined by geography. It is past time to resolve this significant question.

2. a. Respondent has no real answer for the split (because there is none): the "contrary authority" is clear (Hon. Joan N. Feeney et al., 2 *Bankr. L. Manual* § 9:2 (5th ed. June 2024)), with "[s]ome circuits" limiting deriv-

[1] According to respondent, derivative standing is "uniformly permitted in the circuits that have considered the matter." Opp. 6. This is wrong: the Fourth Circuit indeed "considered" the matter, expressed "hostility" to derivative standing (*Racing Services*, *supra*), but ultimately reserved judgment because derivative standing failed there under *any* standard. *Baltimore Energy*, 432 F.3d at 561. Contrary to "permit[ing]" the doctrine, the Fourth Circuit indicated it would forbid the practice in an appropriate case. *Id.* at 560-561.

ative standing to "narrow[er] circumstances than those allowable in the Ninth Circuit" (Pet. App. 19a, 62a). Indeed, this is the rare case where a respondent both acknowledges the circuit conflict, and even admits precisely what that conflict is—candidly flagging "the differing approaches to derivative standing among the circuits, ranging from circuits allowing derivative standing by consent" to "those limiting derivative standing to circumstances where the debtor improperly refuses to bring avoidance claims." Opp. 16. The primary certworthiness factor is therefore indisputably met.

b. In response, respondent insists the conflict is not "material." Opp. 16. This is perplexing: respondent did not "unjustifiably refuse" to sue, but *consented*. Pet. App. 12a, 55a-56a (admitting "Debtors themselves would have prosecuted" these claims). Respondent thus would have lost under settled law in the Third, Fifth, and Seventh Circuits, but instead prevailed because this case happened to arise in Nevada. That is as "material" as it gets. Opp. 16.

Respondent next says petitioners' attack on derivative standing "lacks merit" because respondent indeed prevailed under existing "Ninth Circuit precedent." Opp. 7. This is bewildering: it is the rare petitioner who would *not* lose under the lower court's existing "precedent." The entire point is that existing Ninth Circuit precedent is *wrong*—and respondent would have lost under the *conflicting* authority of three other circuits, the Tenth Circuit BAP, the four-judge Third Circuit dissent, the Fourth Circuit's (hostile) observations, and multiple lower courts. That the Ninth Circuit has "long[]" endorsed "consent-based" derivative standing (Pet. App. 16a, 59a) merely confirms the intractable conflict with circuits *forbidding* that approach.

Respondent finally says review is unwarranted because the (admitted) split does not capture whether derivative standing is ever permitted, downplaying the Tenth Circuit BAP decision, "then-Judge Alito's joinder in a four-Judge [en banc] dissent," and the "different conclusions" reached by "lower court[s]." Opp. 3, 12-15. Yet this clear division is more than enough, especially in the bankruptcy context. Pet. 23 (so explaining). The Third Circuit did not go en banc to correct a trivial disagreement. See Fed. R. App. P. 35(a)(2) (asking whether "the proceeding involves a question of exceptional importance"). The Tenth Circuit BAP decision may not be binding (Opp. 13), but it reflects the considered views of an appellate panel, which is presumably why this Court routinely considers such decisions in tallying certworthy conflicts. Pet. 3 n.2. And the existing conflict and confusion among lower courts illustrates the obvious problems this issue constantly generates. See 7 *Collier on Bankruptcy* ¶ 1103.05[6] ("oft-litigated issue"); Opp. 15 (admitting "countless" decisions on the subject).

Put simply: There is an indisputable circuit conflict after this Court reserved the question in *Hartford*; the majority of circuits have weighed in; multiple judges reject derivative standing as incompatible with the Code; and yet "'most'" courts (Opp. 13) continue to stray further from the Code's actual text. See, *e.g.*, 5 *Collier on Bankruptcy* ¶ 547.11[6] & n.54. It is well past time for a definitive resolution of this important issue, and this case presents the rare opportunity to address each aspect of this fundamental question.

B. The Question Presented Is Exceptionally Important And Warrants Review In This Case—And Respondent's Mootness/Substitution Theory Is Both Forfeited And Frivolous

1. In a transparent effort to dodge review, respondent now insists for the first time (after three rounds of decisions below) that the issue of derivative standing is "moot." Opp. 7-12. According to respondent, the bankruptcy plan named him the "real party in interest," he now "stands in the debtor's shoes," he was "substituted" below under Fed. R. Civ. P. 17(a)(3), and he litigates "on behalf of the estate." Opp. 6-7. Because he says his substitution as trustee "cure[s]" any defect in the Committee's standing, the question presented is no longer relevant. *Ibid.*

a. This is frivolous on every level. There is a reason respondent's new theory does not appear in any of the three decisions below: it is the opposite of the express position respondent took at every prior stage of this case. Respondent was indeed substituted below—as the *successor to the Committee*. Pet. App. 14a, 57a-58a. He limited his notice of appeal as asserting the *Committee*'s interests. No. 22-16143 Supp. E.R. 60-61. He expressly chose to act "through the Committee." Pet. App. 14a, 57a-58a. He claimed he acquired the *Committee's* rights (not the debtors') as "successor-in-interest to the Committee." *Ibid.* And he invoked the specific procedural rule permitting him to proceed as if the *Committee* were still in the case: "[i]f an interest is transferred, the action may be continued by or against the original party." *Ibid.* (quoting Fed. R. Civ. P. 25(c)).[2]

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[2] See also No. 22-16143 C.A. Doc. 27 at 2 ("The Committee believes that the Bankruptcy Court's rulings were gross errors of law. Based thereon, [respondent] (*who succeeded to the rights of the Committee*

This is why *each* court below asked exclusively whether the Committee had derivative standing, not whether respondent's "substitution" somehow mooted the issue. This case was litigated at each stage (before all three courts) on respondent's express assertion that the Committee's interests alone were at stake. This is why there is not a *single* reference to Fed. R. Civ. P. 17(a)(3) below—which would indeed substitute the "real party in interest"—but instead respondent's explicit invocation of Fed. R. Civ. P. 25(c)—which permitted the Committee (and derivative standing) to remain front and center.

Simply put: All three courts below addressed derivative standing (as the sole issue under review) because respondent himself *limited the case to derivative standing*—by insisting he was solely acting "through the Committee" and asserting its rights as "successor-in-interest to the Committee." Pet. App. 14a, 57a-58a. This strategic election is binding on respondent. Attempted substitutions under Rule 17(a)(3) are subject to waiver and forfeiture, and respondent forfeited this tardy contention long ago. *E.g.*, *Ceska Zbrojovka Defence SE* v. *Vista Outdoor, Inc.*, 79 F.4th 1255, 1261 (10th Cir. 2023) (Rule 17 argument forfeited because party "did not invoke Rule 17 below"); *Fed. Treasury Enter. Sojuzplodoimport* v. *SPI Spirits Ltd.*, 726 F.3d 62, 84 n.18 (2d Cir. 2013) (refusing

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under the Debtors' confirmed chapter 11 plan) appealed the Bankruptcy Court's rulings to the District Court.") (emphasis added); No. 21-cv-60, D. Ct. Doc. 10 at 1 (respondent is "successor-in-interest to the Official Committee of Unsecured Creditors"); No. 21-cv-60, D. Ct. Doc. 22 at 9 ("the Liquidating Trust Trustee, as successor-in-interest to the Committee by virtue of the transfer of the Adversary and related Causes of Action to him, will then be in a position to prosecute the Adversary on the merits").

to "remand" to assert a belated Rule 17(a) "'substitution'"). It is too late now to reverse course and take the opposite position for the first time before this Court.[3]

b. This likewise establishes respondent's error that the Court "need not reach" derivative standing because respondent's substitution somehow "cured" any defect. Opp. 6-7. This is upside-down. Respondent's new theory raises a separate procedural question that becomes relevant only *after* deciding whether derivative standing is allowed. The question presented here is the predicate question. There is no need to ask about a "cure" until a court identifies a problem—just as all three courts below decided derivative standing without addressing respondent's (unraised) theory.

c. Nor can respondent sidestep these settled principles by invoking 11 U.S.C. 1123(b)(3)(B) or the bankruptcy plan. Opp. 2, 7-10. Petitioners agree that Section 1123 can assign claims to a liquidating trustee. But the plan here assigned *all* claims, *including the Committee's*. Opp. 5 (so conceding). And respondent then asserted the Committee's rights alone in pursuing this litigation. That was his election and he made it expressly: he filed a notice of appeal solely "through the Committee"; he solely argued that he acquired the Committee's rights; and he expressly

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[3] It is a bit much for respondent to blame the bankruptcy court for not addressing the "substitution" (Opp. 5)—when it was *respondent's* duty to raise the issue, and respondent instead insisted at each stage he was acting "through the Committee" and asserting the Committee's rights. Respondent likewise is wrong that the district court somehow faulted the bankruptcy court for failing to consider the "joinder" issue. Opp. 5-6. The district court focused on the estate's prejudice from rescinding the stipulation *permitting derivative standing*. Pet. App. 24a-25a, 68a. That has nothing to do with respondent's revisionist theory (raised for the first time) that he was actually litigating as the estate—despite mentioning only the Committee.

represented that he was proceeding as the Committee's "successor-in-interest"—without any hint he was also asserting any other rights. Pet. App. 14a, 57a-58a. This is why he continued to argue the Committee had derivative standing, and why each court below exclusively addressed that single question.

Again, respondent is now bound by that strategic election. Parties are not permitted to reinvent their entire case once it reaches this Court. This case arrives on respondent's express assertion that he was acting for the Committee alone and asserting solely the Committee's rights. That perfectly tees up the question presented—and forecloses respondent's (forfeited) new position.

d. In any event, respondent mislabels his new argument. At best, his novel theory presents an alternative ground for affirmance. And while petitioners are confident that ground will fail, the question is irrelevant at this stage: this Court "routinely grants certiorari to resolve important questions that controlled the lower court's decision notwithstanding a respondent's assertion that, on remand, it may prevail for a different reason." Reply Br., *Kisor* v. *Wilkie*, No. 18-15, at 2 (filed Nov. 19, 2018). Respondent cannot avoid review of the important *predicate* issue by predicting how the Ninth Circuit *might* decide respondent's (forfeited) argument on remand.

Aside from forfeiture, respondent's tardy assertion of Rule 17(a)(3) fails on its own terms. A Rule 17 substitution is not automatic; a party must invoke the "procedural" remedy within a "reasonable time" after learning of an alleged defect. *E.g.*, *National Credit Union Admin. Bd.* v. *U.S. Bank Nat'l Ass'n*, 898 F.3d 243, 256-257, 259 (2d Cir. 2018); *DRK Photo* v. *McGraw-Hill Global Educ. Holdings, LLC*, 870 F.3d 978, 989 n.8 (9th Cir. 2017); *Kuelbs* v. *Hill*, 615 F.3d 1037, 1043 (8th Cir. 2010); *Jordan* v. *Fox, Rothschild, O'Brien & Frankel*, 20 F.3d 1250, 1278-1279

(3d Cir. 1994). The correct time for respondent to assert Rule 17(a)(3) was in bankruptcy court. Or at least in district court. And certainly in the Ninth Circuit. But any "reasonable time" surely passed after respondent waited three rounds of litigation (including two separate appeals) before uttering a word to swap out a different "real party in interest."[4]

2. Once respondent's nonsense is set aside, this vehicle is as clean as it gets. This is a pure question of law. It was squarely resolved at all three stages below. There are no conceivable factual disputes: the Committee asserted derivative standing based on the debtor's consent. If unjustified refusals are required, the suit fails. If derivative standing is never allowed (per the Code's plain text), the suit fails. But if consent-based standing is authorized, respondent wins—even though he would lose in three circuits and multiple lower courts.

This question is of obvious legal and practical importance. It is essential for stakeholders to know which parties have the power to initiate high-stakes litigation under the Code. The persistent waste and confusion will continue until this Court intervenes. And in the interim, litigants may lose after years of costly litigation by discov-

[4] Rule 17 substitutions are neither a solution for this case—nor the broader circuit conflict. Rule 17(a)(3) requires a "ready and willing" real-party-in-interest to step in (*Klein on behalf of Qlik Techs., Inc.* v. *Qlik Techs., Inc.*, 906 F.3d 215, 226 (2d Cir. 2018))—a condition that will never be met in those circuits (unlike the Ninth Circuit) requiring an "unjustified refusal" before a committee can sue. In those circuits, the debtor/trustee believes the suit should not be filed, and so no party will be available to cure a committee's lack of standing. A substitution is simply not a realistic option to moot out the issue in half the split.

ering, post-hoc, that derivative standing was unauthorized in the first place. Opp. 3 (inadvertently conceding this point).

Respondent insists the question presented is not "important[t]." Opp. 19. Suffice it to say that multiple courts and experts disagree. The Fourth Circuit declared it "important," "significant," and "difficult." *Baltimore Energy*, 432 F.3d at 560-561. The Third Circuit felt it sufficiently important to warrant a rare en-banc review. Expert commentators have underscored the importance in exhaustive articles and coverage. And it is self-evidently important on its own: it implicates litigation with massive stakes; interferes with the prompt resolution of bankruptcy proceedings; and multiplies litigation by committees who do not always have the estate's best interest at heart.

This Court's immediate review is warranted.

Respectfully submitted.

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AUGUST 2024