No. 25-208

IN THE
Supreme Court of the United States

IN RE: SANCHEZ ENERGY CORPORATION, *et al.*,
Debtors.

DELAWARE TRUST COMPANY, AS LIEN-RELATED LITIGATION CREDITOR REPRESENTATIVE,
Petitioner,

v.

AD HOC GROUP OF SENIOR SECURED NOTEHOLDERS AND DIP LENDERS AND WILMINGTON SAVINGS FUND SOCIETY, FSB,
Respondents.

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

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF

To evade review of the Fifth Circuit's construction of Section 550(a)—what that court called its "dispositive" holding, App. 7a—respondents invent an alternative holding. Respondents erroneously characterize the Fifth Circuit's rejection of *petitioner*'s alternative ground to *affirm* the bankruptcy court based on the language of the plan as an independent ground to *reverse* the bankruptcy court. The Fifth Circuit's opinion does not contain respondents' phantom alternative holding, which would make no sense given the unambiguous orders under review. For that reason, reversing the Fifth Circuit's construction of Section 550(a) would require vacating its judgment.

On the circuit conflict and the merits, respondents offer nothing serious. For example, they have no answer for the Second Circuit's unambiguous holding that Section 550(a) allows an award of both property and value and the Fifth Circuit's mistaken understanding of that decision. And respondents cannot cogently explain what "context" authorizes courts to depart from the Bankruptcy Code's Rules of Construction.

This Court should grant review.

I. The Fifth Circuit Did Not Render An Alternative Holding

The Fifth Circuit stated its holding at the outset of its opinion: "We hold that the [bankruptcy] court's equity allocation contravened the Bankruptcy Code, 11 U.S.C. §§ 550(a) and (d)." App. 2a. Respondents nevertheless argue (Opp. i, 2, 12-15) that the Fifth Circuit rendered an alternative, non-statutory ground for reversing the bankruptcy court. That is incorrect.

Respondents have erroneously characterized the Fifth Circuit's rejection of *petitioner's* alternative ground for *affirming* the bankruptcy court's order based on the language of the plan as a separate basis for *reversing* that order. In truth, because the Fifth Circuit's judgment depended on its rejection of petitioner's Section 550(a) argument, that holding was "dispositive," as the Fifth Circuit stated. App. 2a, 7a.

Recall the procedural posture here. Respondents held pre-petition liens on Sanchez's assets that were potentially avoidable preferences. Respondents then became debtor-in-possession (DIP) lenders, but they agreed that their new, first-priority DIP liens would *not* encumber any award the estate could obtain under Section 550(a) in actions to avoid respondents' pre-petition liens. The bankruptcy court ultimately found the pre-petition liens avoidable and awarded equity based on their value, all as contemplated by the confirmed plan.

Although respondents raised many arguments on appeal, the Fifth Circuit reached only one: their claim that the bankruptcy court erred in holding that the estate's actions to avoid their pre-petition liens had value under Section 550(a). App. 7a. Respondents claimed that, under the proper interpretation of Section 550(a), no value award was permissible for those actions because the plan's release had already "returned" the liens to the estate. C.A. Op. Br. 21. In response, as the Fifth Circuit explained, *petitioner* presented two "alternative[]" arguments for affirming the bankruptcy court. App. 8a-9a.

First, petitioner argued that even if Section 550(a) would otherwise bar a value award, it did not do so here "based on the terms of the Plan." App. 8a. In

Part I of the opinion, the Fifth Circuit rejected that argument, concluding that the plan required the bankruptcy court to apply Section 550(a) in full. App. 9a-14a. Petitioner has not sought certiorari on that plan-interpretation question.

Second, as an "[a]lternative[]" ground for affirming the bankruptcy court's order regardless of the outcome of the first argument, petitioner argued that "Section 550(a) does not prevent a bankruptcy court from awarding 'value' for liens that were worthless when returned to the debtors' estate." App. 8a-9a. In Part II of the opinion, the Fifth Circuit rejected that argument, declaring that "[c]ourts cannot award value under Section 550(a) when the estate has recovered its transferred property in kind." App. 19a; *see id.* at 14a-20a. Petitioner has sought certiorari on that "dispositive" holding, App. 7a.

The Section 550(a) question is thus cleanly presented for review. That petitioner did not also seek certiorari on an alternative ground for *affirmance* presented below does not bar this Court from resolving the question presented.

Respondents nevertheless claim (Opp. 13-14) that the Fifth Circuit's opinion contains an alternative holding that the terms of the plan, by themselves, eliminated the need to value the avoidance actions. Respondents rely primarily on the last paragraph of Part I of the opinion and the conclusion. There, the court stated that a "necessary consequence of the Plan" is that once the DIP liens were upheld as valid, respondents "should have been entitled to one hundred percent" of Mesquite's equity, because the plan allowed "unsecured creditors to recover some equity *only if* they were able to defeat the DIP liens," App.

14a, and that further litigation was "unnecessary" once the DIP liens were upheld, App. 20a.

Respondents say those passages mean that because the bankruptcy court validated the DIP liens, it was unnecessary to value the avoidance actions, even if they had value under Section 550(a). That is incorrect. Read in context, the statements were simply saying that because the DIP liens were valid *and* the avoidance actions were necessarily worthless under Section 550(a) as a result of the plan's lien release, respondents were entitled to 100% of the equity. In other words, the Fifth Circuit believed further litigation "unnecessary" because of its dispositive holding that the avoidance actions had no value under Section 550(a). For several reasons, respondents' contrary reading is indefensible.

First, it is undisputed (and indisputable) that while the DIP liens encumbered all of Sanchez's other assets, they did not encumber Section 550(a) actions to avoid respondents' liens and the proceeds thereof. *See* Pet. 8. Put differently, whatever value those actions had was reserved for the estate; it was not collateral for the DIP loans. As a result, the mere validity of the DIP liens could not alone foreclose the need to value the avoidance actions.

That the avoidance actions were carved out from the DIP liens is clear from the DIP order:

> [T]he DIP Superpriority Claims *shall have no recourse* to Sanchez's claims and causes of action under sections 502(d), 544, 545, 547, 548 and 550 of the Bankruptcy Code, or any other avoidance actions (collectively, "Avoidance Actions") or the proceeds thereof * * *

App. 311a (emphasis added). As the bankruptcy court explained—in a conclusion undisturbed by the Fifth Circuit—"the DIP Lenders' superpriority claims did not have recourse to the proceeds of Avoidance Actions against [respondents]." App. 47a-48a. Tellingly, in describing the DIP liens (Opp. 5), respondents omit this critical carve-out, acknowledging it only later in a footnote (Opp. 9 n.1). That reluctant concession defeats respondents' alternative-holding claim: Because the DIP liens did not encumber the avoidance actions, their validity could not have eliminated the need to determine the value of the avoidance actions—value reserved for the unsecured creditors.

Second, respondents did not argue in the Fifth Circuit that even if the avoidance actions had value under Section 550(a), respondents would be entitled to 100% of the equity solely because the DIP liens were valid. As noted, they could not make that argument with a straight face, because the proceeds of the avoidance actions were expressly shielded from the DIP liens.

Third, the Fifth Circuit stated that its holding was limited to the Section 550(a) issue, App. 2a, explained that its construction of Section 550(a) was "dispositive," App. 7a, and summarized the two questions that it would address (corresponding to petitioner's two alternative grounds for affirmance), App. 8a-9a. It did not identify any alternative basis to reverse relating to the validity of the DIP liens.

Fourth, in the same paragraph containing the sentences that respondents cite, the Fifth Circuit stated that "the Plan in no way limited the lenders' ability to mount defenses consistent with Section 550(a) and other applicable law." App. 14a. That clarifies that

the court's point was that once the DIP liens on assets other than the avoidance actions were held valid *and* the avoidance actions were deemed worthless as a matter of law by virtue of the court's interpretation of Section 550(a), the ensuing trial to value those actions was unnecessary.

Finally, in rejecting petitioner's statutory argument in Part II of its opinion, the Fifth Circuit did not state that it was adopting an alternative ground for reversal. App. 14a-20a. Rather, it framed the statutory analysis as the logical next step given its plan construction: "Because the Plan and the Lien Challenge Complaint must be interpreted in light of Sections 550(a) and (d), and it is dubious in any event that the parties could agree to ignore a controlling provision of the Bankruptcy Code when seeking a preference recovery, we next apply those provisions." App. 14a-15a. That is consistent with the Fifth Circuit's description of its holding, the parties' arguments, and the orders under review.

II. It Is Important For This Court To Resolve The Entrenched Circuit Conflict

Respondents cannot seriously dispute that the Fifth Circuit's interpretation of Section 550(a) to forbid an award of both value and property creates a circuit conflict. Instead, respondents pretend like the decision below was limited to the context of "nonpossessory liens" (Opp. 2-3, 16-18, 27-29, 31-32) or describe how the facts of other cases differed (Opp. 19, 20, 23-24). But the Fifth Circuit's construction was not limited to nonpossessory liens or to any particular factual scenario. Rather, it held categorically that a value award is never available under Section 550(a)

when the property has already been returned. App. 16a-19a. The Second, Ninth, and Tenth Circuits have held otherwise. Pet. 19-27. To the extent respondents have preserved any lien-specific or fact-specific arguments, they can raise those on remand (although respondents have never disputed that the transfer of a lien can be a preference, *see* Pet. 7; 11 U.S.C. § 101(54)).

Respondents' discussion of the circuit decisions obscures their holdings. Take their treatment of the Second Circuit's decision in *In re TransCare Corp.*, 81 F.4th 37 (2023), which upheld a value award even though the property at issue (called the "Subject Collateral") had been returned to the estate. *Id.* at 56-58. Respondents say (Opp. 20-21) that this holding was "unclear" because another part of the opinion addressing a different issue stated that generally a trustee can recover value "rather than" property under Section 550(a). 81 F.4th at 57. There is no ambiguity. Section 550(a) *does* allow a trustee to recover value "rather than" property. But, as both the Second Circuit majority and Judge Menashi concluded, it *also* allows a mixed award when necessary to return the estate to its pre-transfer position. *See id.* at 56-58; *id.* at 61 (Menashi, J., dissenting).

Respondents further claim (Opp. 22-23) that it is "also unclear" whether only "a subset of the collateral ha[d] been recovered" in *TransCare*. It is not. The opinion states that the transferees "transferred the Subject Collateral back to the Trustee." 81 F.4th at 47. Respondents point to statements from the dissent and the district court supposedly suggesting that only a portion of the returned property was *liquidated*. But that is irrelevant. Respondents concede (Opp. 20, 23)

that the Second Circuit approved a $40 million value award for at least part of the Subject Collateral, all of which had been returned to the estate. That conflicts with the decision here.

Finally, respondents claim (Opp. 21) that the construction of Section 550(a) was "not the focus of the appeal" in *TransCare* and "received scant attention." They are wrong about that, too. The appellant's *lead* argument on damages was that under Section 550(a) the "Bankruptcy Code * * * gives the Trustee a choice: recover *either* the Subject Collateral *or* its value." *TransCare* C.A. Op. Br. 52 (internal citation omitted); *TransCare* C.A. Reply Br. 23-24 (similar). The Second Circuit disagreed. And while the Fifth Circuit stated that its construction of Section 550(a) was consistent with *TransCare*, App. 17a n.8, it clearly misapprehended *TransCare*'s holding.

Similarly flawed is respondents' treatment of the Ninth Circuit's decision in *In re Straightline Investments, Inc.*, 525 F.3d 870 (2008). Respondents say that the decision (Opp. 18-19) approved a value award only for discrete property interests that were not returned to the estate. But that is not how the Ninth Circuit framed its holding. Rather, it described a single unified property interest and approved the bankruptcy court's decision to award "a monetary recovery for *part of the value* of the improperly transferred property." *Id.* at 883 (emphasis added). And it justified that holding on the ground that "[a]lthough the statute contains the conjunction 'or,' * * * the bankruptcy court may award a judgment that involves both types of recovery, as long as it does not result in a double recovery for the estate." *Id.* at 883 n.3. It is thus unsurprising that jurists have cited *Straightline* for

the proposition that Section 550(a)'s remedies are not mutually exclusive. *In re Belmonte*, 931 F.3d 147, 154 (2d Cir. 2019); *TransCare*, 81 F.4th at 61 (Menashi, J., dissenting); *In re Williams*, 658 B.R. 591, 607 (Bankr. D. Mont. 2024).

As for *In re Trout*, 609 F.3d 1106 (10th Cir. 2010), respondents virtually ignore (Opp. 16-18) its entire substantive discussion of Section 550(a). *See* 609 F.3d at 1109-13. The upshot of that discussion is that "§ 550(a) provides the bankruptcy court with flexibility to fashion a remedy so as to return the estate to its pre-transfer position" and that "there may be situations in which the avoidance of the lien will not suffice to restore the estate to a pre-transfer situation." *Id.* at 1111, 1112. That understanding is irreconcilable with the Fifth Circuit's flat prohibition on value awards when the property has been returned. Like the Fifth Circuit, respondents rely (Opp. 17) on a footnote summarizing the trustee's position that under the single-satisfaction rule (not the text of Section 550(a)), it could not acquire "the lien *and* a monetary award of the value of the lien." 609 F.3d at 1108 n.2. But that concession made sense on the facts since the lien still had value, unlike here.

That said, even if respondents were correct about *Trout*, that would only underscore the need for this Court's review to resolve a 2-2 circuit conflict (or 2-3, if the Court credits a nonprecedential Fourth Circuit case that respondents cite (Opp. 18)).

III. The Fifth Circuit Misconstrued Section 550(a)

The decision below misreads Section 550(a). The Bankruptcy Code states that "'or' is not exclusive," 11

U.S.C. § 102(5), but the Fifth Circuit held that the word *is* exclusive in Section 550(a). The court justified that holding by explaining that Section 550(d) limits the estate to a "single satisfaction." App. 16a. But that upper bound is perfectly consistent with allowing an award of property and value sufficient to return the estate to its pre-transfer position—*i.e.*, to award the estate a full satisfaction of the value it lost in the transfer.

Apart from namechecking individual judges, respondents offer little to defend the Fifth Circuit's defiance of the Code's Rules of Construction. They largely just quote (Opp. 25-26) the court's statements without addressing the basic problem that nothing about the single-satisfaction rule dictates the court's interpretation of Section 550(a). They also repeat (Opp. 27-28) the Fifth Circuit's accusation that petitioner's reading is "purposive," App. 17a, but it is petitioner's reading that adheres to the Rules of Construction, while the Fifth Circuit cast aside that plain language for no justifiable reason, App. 16a.

Respondents raise hypotheticals (Opp. 29-31) in which it would be unfair to award value for a transferred lien. Under petitioner's plain-text reading of Section 550(a), however, bankruptcy courts enjoy ample discretion to decline to award value when doing so would provide a windfall to the estate. The Fifth Circuit's interpretation, in contrast, categorically deprives bankruptcy courts of discretion to award both property and compensating value even for tangible property like cars, inventory, and machinery.

It is revealing that respondents have no answer to petitioner's vehicle hypothetical—responding (Opp. 29-30) only with a different hypothetical about a lien

on a vehicle. The reality is that under the Fifth Circuit's construction of Section 550(a), a distressed company could fraudulently transfer a vehicle or other property, and the transferee could then use the property for its own benefit, deplete the property of substantial value, and return it to the debtor with no further liability.

Respondents say (Opp. 31) that in that situation, a court could choose to award full pre-transfer value in lieu of the property. But that would not be possible where the transferee returned the property before the bankruptcy filing (to the same managers who authorized the fraudulent transfer in the first place). The potential for abuse is limitless. An affiliated transferee could return real property after encumbering it by debt or depleting it of valuable minerals, or could return stock after it fell in value or livestock after it has aged. The Fifth Circuit's erroneous statutory holding provides the blueprint for such mischief.

IV. The Case Is A Straightforward Vehicle To Resolve An Important Question

Respondents maintain (Opp. 31-34) that the meaning of one of the most frequently applied provisions of the Bankruptcy Code is insufficiently important for this Court's review. But five circuits have addressed the issue, and the Fifth Circuit suggested that there exists a substantial body of on-point lower-court decisions, *see* App. 19a & n.9.

Respondents' purported vehicle problems (Opp. 31-34) are illusory. As explained above (pp. 1-6, *supra*), the Fifth Circuit did not render any alternative ground for reversal. And its holding was not limited to nonpossessory liens. *See* pp. 6-7, *supra*.

Respondents note (Opp. 31-32) that the plan here had some unusual features, but that is irrelevant to the Section 550(a) question.

Respondents also advert (Opp. 28-29, 34) to arguments they raised below that the Fifth Circuit did not reach. If this Court corrects the Fifth Circuit's statutory error, the Fifth Circuit can address those arguments on remand. Those arguments, moreover, turn on a host of contested issues, such as whether "harm" to the estate is necessary for a Section 550(a) value award (Opp. 28-29), notwithstanding respondents' speculation (Opp. 34) about what the Fifth Circuit will "inevitably" do on remand.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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