No. 16-972

In the
Supreme Court of the United States

CHESAPEAKE ENERGY CORPORATION,

Petitioner,

v.

BANK OF NEW YORK MELLON TRUST COMPANY, N.A.,

Respondent.

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

REPLY BRIEF OF PETITIONER

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REPLY BRIEF

BNYM does not dispute that the Second Circuit's decision renders a declaratory judgment effectively worthless until every opportunity for appellate review has been exhausted, even when a declaratory-judgment loser has neither sought nor obtained a stay. That holding makes the Declaratory Judgment Act feckless in the precise circumstances for which it was designed—*i.e.*, when a party, like Chesapeake, asserts rights that are both hotly contested and time-sensitive. Here, Chesapeake never would have redeemed its Notes without first obtaining a valid, unstayed district court judgment declaring the redemption lawful. Yet Chesapeake now finds itself facing a highly punitive, nine-figure judgment just as if it had acted at its peril. The upshot of the decision below is that it leaves Chesapeake (and similarly situated parties) worse off for having gone to district court and *won* than had it gone to court and *lost*. It renders an unstayed declaratory judgment as nothing more than the district court's non-binding "best guess" as to the legal question addressed.

BNYM disputes none of this. Instead, it tries to evade review by asserting implausibly that the question presented turns exclusively on state law; that the decision below will impact only the parties; and that litigants always act at their peril even if they possess a valid, unstayed declaratory judgment because every district court decision could be reversed on appeal. None of those theories holds water. Once Chesapeake secured a declaratory judgment from a federal court under the authority of the federal Declaratory Judgment Act, the effect of

that judgment became a distinctly federal question, without regard to whether the underlying dispute arose under state or federal law. This Court's cases recognize as much—including *Edgar v. MITE Corp.*, the linchpin of BNYM's entire misguided theory. *See* 457 U.S. 624 (1982) (federal law determines protective effect of federal district court's preliminary injunction, although liability arose under state law).

The same basic problem undermines BNYM's effort to deny a conflict between the decision below and decisions of this Court and other circuits. The effect of a valid, unstayed declaratory judgment does not turn on whether the underlying issue involves contract law or statutory rights or whether the plaintiff seeks to avoid criminal penalties or civil liability. This Court's cases make clear that a valid, unstayed declaratory judgment protects the rights of the declaratory-judgment winner, without regard to the nature of the legal question that underlies the declaratory judgment. And certainly if there is going to be a counterintuitive and expectation-defying exception to that rule, it should be announced by this Court, not the Second Circuit.

In sum, the question presented here is a broad question of federal law that has sown widespread confusion in the lower courts. Neither the Declaratory Judgment Act nor this Court's precedents countenance the decision below, which will eviscerate the declaratory judgment mechanism in the precise circumstances in which it is *most* valuable—when litigants prudently seek to clarify their rights before taking a time-sensitive action. Certiorari is warranted.

I. The Decision Below Is Wrong And Exacerbates Widespread Confusion Among The Lower Courts.

A. The Second Circuit's Decision Is Contrary to the Text and Purpose of the Declaratory Judgment Act.

BNYM offers no meaningful response to Chesapeake's demonstration that the decision below defies the Declaratory Judgment Act's text and core purposes. As for the text, a declaratory judgment serves to "declare the rights and other legal relations" of the parties, and "[a]ny such declaration shall have the force and effect of a *final judgment or decree* and *shall be reviewable as such*." 28 U.S.C. §2201(a) (emphasis added). In no other area of law is a valid, unstayed "final judgment or decree" treated as meaningless or illusory until all appeals have run their course. *See* Pet.17. The Act's text thus forecloses the Second Circuit's conclusion that an unstayed declaratory judgment is merely tenuous—and that a party relies on that judgment at its peril—while it is being appealed.

Nor does BNYM dispute that the decision below leaves courts powerless to afford *any* meaningful protection to the scores of parties whose rights are contested, but who face a time-sensitive dilemma that may not outlast the years-long appellate process. Under the Second Circuit's approach, such parties face the unmitigated risk of liability—and hence undiminished pressure to relinquish their rights by forgoing their contemplated actions—even if they have in hand a favorable judgment from a federal district court. Yet "[t]he dilemma posed by that

coercion—putting the challenger to the choice between abandoning his rights or risking [severe penalties]—is 'a dilemma that it was the very purpose of the Declaratory Judgment Act to ameliorate.'" *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 129 (2007). The decision below makes such amelioration impossible in a broad class of cases. *See* Pet.19-22.

That result is especially intolerable because it creates a fundamental asymmetry that puts the prevailing party in a declaratory judgment action in a worse position than the losing party. The declaratory-judgment loser can always seek a stay if it believes the district court erred and wants to prevent the declaratory-judgment winner from exercising its judicially determined rights while an appeal is pending. There is *nothing* the declaratory-judgment winner can do, by contrast, to ensure that its district-court victory will protect it if it acts in reliance on the unstayed judgment. That result conflicts with common sense and longstanding principles of federal equity. *See, e.g.*, *Ex parte Young*, 209 U.S. 123, 147-48 (1908); *Wadley S. Ry. Co. v. Georgia*, 235 U.S. 651, 668 (1915).

B. The Decision Below Departs From This Court's Precedents.

BNYM also makes little effort to square the Second Circuit's holding with this Court's precedents. BNYM does not dispute that *Oklahoma Operating Co. v. Love*, 252 U.S. 331 (1920), *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293 (1943), and *Doran v. Salem Inn, Inc.*, 422 U.S. 922 (1975), establish that a party who wins declaratory relief in

the district court is expected and entitled to rely on it, and that such party may not be made *worse off* for having won and relied on its unstayed judgment. *See* Pet.24-25.

BNYM asserts that those cases "turn on irrelevant concepts of punishment and blameworthiness." Opp.25. But nowhere do those decisions suggest that the laws at issue tied liability to the actor's "blameworthiness." Instead, each case either held or took for granted that a then-valid federal judgment would—*of its own force*—prevent the imposition of liability beyond restitution. Moreover, threatened "punishment" would not distinguish those cases from this one: the Make-Whole Price BNYM seeks to recover is a highly unfavorable redemption price (to the tune of several hundred million dollars) that is both punitive and designed to deter untimely redemptions.

Searching for a helpful precedent, BNYM seizes on *W.R. Grace & Co. v. Local Union 759*, 461 U.S. 757 (1983). Opp.18, 27, 32. But *W.R. Grace* held only that an employer who terminated an employee in reliance on a later-reversed district court order could be assessed "backpay damages," 461 U.S. at 759, which would restore the parties to the positions they would have occupied had the employer not won and relied on the order. Far from supporting BNYM's position, *W.R. Grace* underscores that the proper remedy following an appellate reversal of an unstayed judgment is an equitable remedy that restores the status quo *ante* and ignores neither the appellate reversal nor the reality of the district court judgment. *See* Pet.26-30. Nothing in *W.R. Grace*

contemplates making a party *worse off* for having won and relied on an unstayed declaratory judgment.

C. The Second Circuit's Decision Deepens Pervasive Disagreement Among the Lower Courts.

The decision below both illustrates and deepens longstanding division in the lower courts about what liability befalls a party who relies on an unstayed lower-court judgment that is subsequently reversed. *See* Pet.31-34.

BNYM fails to distinguish the cases discussed in Chesapeake's petition. First, BNYM contends that *Clarke v. United States*, 915 F.2d 699 (D.C. Cir. 1990) (en banc), and *United States v. Mancuso*, 139 F.2d 90 (3d Cir. 1943), are inapposite because they "concern the significance of *mens rea* to criminal liability." Opp.20. The cases say otherwise. As the D.C. Circuit explained, "a federal judgment, later reversed or found erroneous, is a defense to a federal prosecution for acts committed while the judgment was in effect," *wholly apart from* "whether appellees had the state of mind necessary for a violation." *Clarke*, 915 F.2d at 701-02. Likewise, the Third Circuit reversed Mancuso's conviction *even though* "it is true that men are, in general, held responsible for violations of the law, whether they know it or not." *Mancuso*, 139 F.2d at 92. Far from suggesting that the governing statute was an exception to that general rule, the court reasoned broadly that "until the [district court's judgment] was vacated, … it stood and the litigant can hardly be asked to determine at his peril the correctness of the court's decision." *Id.*

BNYM dismisses the rest of Chesapeake's cases by claiming they involved declaratory judgments that "compel[led] a government party to act," Opp.21, or "coerce[d] behavior," Opp.23 (emphasis omitted). That distinction fails, for *every* declaratory judgment "is not ultimately coercive." *Steffel v. Thompson*, 415 U.S. 452, 471 (1974).

Finally, BNYM suggests that *Munoz v. MacMillan*, 124 Cal. Rptr. 3d 664 (Cal. Ct. App. 2011), rejected Chesapeake's theory in the contract context. Opp.24. But *Munoz* did not involve a reversed *federal* judgment at all, nor did it address the federal Declaratory Judgment Act. Moreover, the court strongly implied that the contract damages at issue there would closely resemble restitution, and reiterated that restitution is the appropriate remedy following appellate reversal. *See* 124 Cal. Rptr. 3d at 671-74 & n.7.[1]

D. At a Minimum, the Court Should Hold This Petition for *Nelson v. Colorado*.

This Court will soon decide *Nelson v. Colorado*, No. 15-1256, which, like this case, asks what remedy is appropriate when a party acts under a judgment that is later reversed. Both Chesapeake and the petitioner in *Nelson* cite many of the same cases establishing the traditional rule that, following reversal, courts award restitution to restore the status quo *ante*. *Compare* Br. for Pet'r, No. 15-1256

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[1] BNYM (at 2) also cites *Isler v. Texas Oil & Gas Corp.*, 749 F.2d 22 (10th Cir. 1984), but that case did not involve a reversed judgment, a declaratory judgment, or anything else resembling the issues presented here.

at 26-30 (citing cases such as *Arkadelphia*, *Nw. Fuel*, and *Baltimore & Ohio R.R.*), *with* Pet.26-30 (same).

BNYM seeks to distinguish *Nelson* on its facts. Opp.36-37. But the petitioner in *Nelson* disagrees, arguing that the rule of restitution-after-reversal applies throughout the law—and "[*c*]*riminal cases are no exception*." *Nelson* Pet'r.Br.28 (emphasis added). Both this case and *Nelson* implicate the same core principles regarding remedies after an appellate reversal. If the Court does not grant certiorari outright, a hold for *Nelson* is warranted.

II. The Decision Below Has Far-Reaching Implications For Other Cases.

Although BNYM barely addresses the text and purpose of the Declaratory Judgment Act, it does insist that the decision below is "fact-bound" and "context-specific with little application beyond the 'unusual series of events here.'" Opp.2. That is wishful thinking.

At the outset, the decision below relies heavily on the uncertainty of appellate outcomes, imposing no cognizable limitations on the breadth of its holding. As BNYM itself concedes, the decision below establishes that, "*like every other final judgment*, a declaratory judgment is subject to appeal and may be reversed," and that "'*every litigant* is painfully aware of the possibility that a favorable judgment of a trial court may be reversed on appeal.'" Opp.30-31 (emphasis added).

BNYM now tries to confine its theory to contract cases, *see* Opp.19-28, but it told the district court a different story, stressing that "[t]his rule *is not unique to contracts*: Actions taken in reliance on a

district court's declaratory judgment are not immunized from liability if that judgment is reversed." Dist.Dkt.188 at 6 (emphasis added). The lower courts agreed. Both "simply held that the declaratory judgment was, like any other appealed order, not yet a full and final resolution of the controversy," CA2.Dkt.116 at 9, and that "a party relies on a declaratory judgment at its peril if the judgment remains subject to appeal," BNYM Br.1.

BNYM's earlier recognition that its proposed rule "is not unique to contracts" is correct. The Declaratory Judgment Act contains no exception for contract disputes, nor does it suggest that a declaratory judgment could be "tenuous" in that context alone. Rather, the Act empowers district courts to enter final judgments "declar[ing] the rights and other legal relations of any interested party," 28 U.S.C. §2201(a), no matter where those rights originate or what source of law defines them.

BNYM argues that this case is unique because the Make-Whole Price is not a "penalty" like the liability threatened in non-contract cases, Opp.15-17, but that blinks reality. The Make-Whole Price is unquestionably a "penalty" because it is designed to deter early redemptions by imposing a massive, nine-figure premium over the present value of the Notes if held to maturity. Pet.5-6 & n.2. Like assessing treble damages against a patent infringer, enforcing the Make-Whole Price would penalize Chesapeake by imposing far more liability than necessary to unwind the effects of its redemption. Fear of such liability coerces the party to forgo whatever conduct might arguably trigger it—which creates the real-world

dilemma the Declaratory Judgment Act was designed to alleviate. And it makes no difference that the Make-Whole Price is a "bargained-for term." Opp.16; *see, e.g.*, *MedImmune,* 549 U.S. at 130 n.9 ("the relevant coercion is … the consequences of failure to" "compl[y] with the claimed contractual obligation").

Finally, BNYM asserts that Chesapeake was "warn[ed] about the risk" of early redemption. Opp.30. But any such warnings sprang from the district court's erroneous belief that an unstayed declaratory judgment confers no protection until all appeals have been exhausted. That "warning" thus does nothing to diminish the imperative need for this Court's review.

III. This Dispute Turns On A Federal Question.

Merits aside, BNYM insists there is nothing this Court can do because state law alone determines whether Chesapeake's declaratory judgment affords protection for acts taken in reliance on it. Opp.13-18. Not so: the question presented is a federal question about the proper construction of the Declaratory Judgment Act, the scope of relief it empowers federal courts to award, and the effect of declaratory decrees in light of federal equitable principles.

BNYM's appeal to *Erie* is a non-sequitur. This case is a state-law contract dispute between diverse parties, and BNYM's claim for damages arises under state law. But the fact that Chesapeake's liability arises under state law says nothing about whether federal law might supply a defense or immunity to such liability, and there is nothing unusual about a party invoking federal law to defend against a state-law claim for breach of contract. *See, e.g.*, *Caterpillar*

Inc. v. Williams, 482 U.S. 386, 393, 388 (1987) (discussing "federal defense[s]" to "state-law complaint for breach of individual employment contracts"); *Kaiser Steel Corp. v. Mullins*, 455 U.S. 72, 83-84 (1982) (enforcement of "private agreements" is subject to "the restrictions and limitations of the public policy of the United States").

Here, Chesapeake raised a defense grounded in federal law: that having exercised rights recognized in a federal declaratory judgment, it cannot be subjected to state-law liability for those actions as if the federal judgment never existed. That is a federal question just as it was in *MITE Corp.* and *Oklahoma Operating Co.*, both of which involved parties whose threatened liability arose out of state law, and who sought protection by virtue of having relied on a federal-court judgment blessing their conduct.

In *MITE Corp.*, MITE challenged a state statute in federal district court and won a preliminary injunction; it then violated the statute while that decree was in effect. 457 U.S. at 629-30. On appeal, MITE argued that its case was moot because even if the statute were upheld, "the preliminary injunction issued by the District Court is a complete defense to civil or criminal penalties." *Id.* at 630. The question was whether a "federal injunction [is] tantamount to a grant of immunity" for actions taken in reliance on it "while the injunction remain[s] in effect." *Id.* at 647 (Stevens, J., concurring). Although the Court did not resolve what protection MITE's federal judgment conferred, at least five Justices agreed the issue presented a federal question. *See id.* at 647-48, 652 (MITE was seeking a "federal rule of law that would

require the state courts to absolve MITE from liability," which would turn on the "prior equity practice" of the federal courts and "the proper nature of injunctive and declaratory relief"); *id.* at 663-64 (Marshall, J., joined by Brennan, J., dissenting) (MITE's state-law liability presented "an important question of *federal* law"); *id.* at 646 (Powell, J., concurring in part); *id.* at 666 (Rehnquist, J., dissenting).

Similarly, *Oklahoma Operating Co.* held that a State could not impose penalties on a party who violated state rate regulations under cover of a federal court's preliminary injunction. 252 U.S. at 338. To do so, it plainly fashioned a rule of federal law to give effect to the earlier federal injunction.

Just like this diversity case, those cases involved state substantive law that federal courts were bound to apply. Yet that was no impediment to shielding a party from the full measure of state-law liability based on its reliance on a federal court's then-valid, unstayed judgment. So too here. The protective effect of a later-reversed federal-court judgment is a question of federal law. That understanding also accords with the broad principle that "the construction or effect of a … judgment, decree, or order or other act done under and by virtue of the authority of a court of the United States or a claim of immunity thereunder" constitutes a federal question. *Tullock v. Mulvane*, 184 U.S. 497, 509 (1902).

CONCLUSION

The petition should be granted.

Respectfully submitted,

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