No. 08-1232

In The
# Supreme Court of the United States

CARLYLE FORTRAN TRUST,

*Petitioner,*

vs.

NVIDIA CORPORATION, et al.,

*Respondents.*

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

## REPLY TO OPPOSITIONS TO PETITION FOR WRIT OF CERTIORARI

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## I. REVIEW IS NECESSARY TO RESOLVE IRRECONCILABLE CONFLICTS REGARDING THE INTERPRETATION OF THIS COURT'S DECISION IN *CAPLIN*

### A. The Conflict Is Irreconcilable, Not "Illusory"

The appellate decisions interpreting *Caplin v. Marine Midland Grace Trust Co. of New York*, 406 U.S. 416, 428 (1972), demonstrate the profound and irreconcilable conflicts among the circuits regarding a bankruptcy trustee's standing to pursue "general" creditor claims. While Respondents' surmise that these conflicts are "illusory," the circuits recognize that the conflicts are very real. *E.F. Hutton & Co. v. Hadley*, 901 F.2d 979, 987 (11th Cir. 1996) ("We recognize that there has been **divergence among the circuits** concerning the ability of a bankruptcy trustee to bring actions against third parties on behalf of creditors of the bankrupt."); *St. Paul Fire and Marine Ins. Co. v. PepsiCo, Inc.*, 884 F.2d 688, 696 (2d Cir. 1989) ("The courts that have considered this issue, however, have reached **differing conclusions**."); *Koch Refining v. Farmers Union Cent. Exchg., Inc.*, 831 F.2d 1339, 1349 (7th Cir. 1987) ("Two recent appellate opinions (released since the writing of the above *Koch* opinion but prior to its publication) have decided this issue of a trustee's standing in **diametrically opposite ways**."); *Jones v. Hyatt Legal Services (In re Dow)*, 132 B.R. 853, 862 (Bankr. S.D. Ohio 1991) ("There presently is a **split among the circuits** on the issue of a trustee's ability to

bring actions against third parties on behalf of creditors of the debtor"); *In re Miller*, 197 B.R. 810, 814 (W.D.N.C. 1996) ("These **two lines of cases** raise a question that was not asked, and therefore was not answered, in *Caplin*."); David Curry & Sajida Mahdi, *Newly Emerging Standard on Trustee's Standing to Assert Claims on Behalf of Creditors*, 120 BANKING L.J. 917, 918-19 (2003) ("Many courts continue to believe that *Caplin* remains good law and are generally unwilling to permit the trustee to assert the claim unless it involves a voidable transfer of property or debtor itself could have asserted it outside of bankruptcy. . . . Over time, however, an **emerging doctrine of standing** has seeped into the decisions of a number of courts **despite the absence of any statutory authority**."); Richard J. Corbi, *Causes of Action: What Is and Is Not Part of the Bankruptcy Estate?*, 17 NORTON J. BANKR. L. & PRAC. 4 (2008) ("There are **divergent views** as to how the courts answer this question.").

In *Caplin*, the debtor corporation executed an indenture with an indenture trustee pursuant to which the debtor issued debentures in the amount of $8,607,600. To protect the debenture holders, the debtor covenanted to file certain certificates with the indenture trustee regarding debtor's obligation to maintain an asset to liability ratio of 2:1. "By requiring the company to maintain an asset-liability ratio of 2:1, the indenture sought to protect debenture purchasers by providing a cushion against any losses that the company might suffer in the ordinary course

of business." 406 U.S. at 418. The debtor "sustained substantial financial losses in every year" from 1959 to 1965 without the debenture holders' knowledge because the indenture trustee failed to fulfill its obligation to confirm the accuracy of the debtor's certificates. *Id.* The debenture holders had a "general" claim against the indenture trustee since every debenture holder could make the claim. Yet, the Supreme Court held that the creditors (i.e., the debenture holders), not the reorganization trustee, had standing to pursue claims against the indenture trustee for failing to disclose the company's losses. *Id.* at 434. *Accord Mixon v. Anderson (In re Ozark Rest. Equip. Co.)*, 816 F.2d 1222, 1223, 1228 (8th Cir. 1987) (creditors, rather than reorganization trustee, had standing to sue directors and officers of the debtor corporation as alter egos for "abuses of the corporation").

In *Caplin*, however, the debenture holders were merely one class of creditors, not all creditors. Although the analysis should not differ on that basis alone, that one distinction has created a profound "divergence among the circuits," which has not been addressed by the Supreme Court since *Caplin*. *See Mixon*, 816 F.2d at 1228 ("*Caplin* is still good law and is **the only Supreme Court case to address the standing question**"); Seymour Roberts, Jr., NORTON ANN. SURV. OF BANKR. LAW, Part I § I (2004) ("The concept of standing is omnipresent, as will be illustrated with respect to the standing of a trustee to bring causes of action on behalf of an estate, the

exception to a trustee's standing, the exception to the exception to a trustee's standing, and the exception to the exception to the exception to a trustee's standing. **This area of the law, to paraphrase a quote from Winston Churchill, is a riddle, wrapped in a mystery, inside an enigma**.").

After 37 years of confusion and turmoil among the circuits, it is time for the Supreme Court to open the enigma, unwrap the mystery, and unlock that riddle.

### B. A "General" Injury To Creditors Is Not Necessarily An Injury To The Debtor

Respondents attempt to skirt the issue by arguing that the Ninth Circuit determined that Carlyle alleged "an injury to the bankrupt corporation itself" rather than an injury to creditors "generally," and that Courts of Appeal "universally agree" that a claim alleging injury to the bankrupt corporation belongs to the reorganization trustee rather than to the creditors. The embedded premise in Respondents' characterization is that if a claim can be asserted by all creditors, that claim must somehow belong to the debtor. From that embedded premise, Respondents argue that, therefore, only the trustee has standing to assert such general creditor claims. The injury at issue here, however, is an injury to the creditors, not to the debtor (3dfx). While 3dfx may have alleged an injury (inadequate consideration) arising out of its transaction with nVidia, the injury suffered by the

creditors is a different injury which arose out of that same transaction, but which had nothing to do with the adequacy of the consideration paid to 3dfx.

Carlyle's complaint alleged that nVidia and 3dfx conspired to divert 1,000,000 shares of nVidia stock to 3dfx's shareholders, officers and directors, at the expense of 3dfx's creditors. nVidia initially offered to pay $100,000,000 cash for substantially all of 3dfx's assets. 3dfx rejected the offer and demanded that nVidia pay $70,000,000 cash and 1,000,000 shares of nVidia stock (then worth over $50,000,000). The 1,000,000 shares of nVidia stock, however, had to be reserved for 3dfx's insiders, and would be given to 3dfx for its shareholders, officers, and directors only if 3dfx were able to discharge over $119,000,000 in liabilities owed to 3dfx's creditors with only the $70,000,000 in cash. If successful, 3dfx would have received assets worth $120,000,000 ($70,000,000 cash plus $50,000,000 in stock), rather than $100,000,000. Even if 3dfx succeeded, however, the creditors of 3dfx were certain to lose $30,000,000 (the difference between the $100,000,000 and the $70,000,000 available to the creditors). 3dfx failed, filed bankruptcy and its reorganization Trustee sued nVidia for fraudulent transfer and successor liability. If 3dfx had succeeded in discharging $119,000,000 in liabilities with only $70,000,000, however, 3dfx would have suffered no loss, as it would have recovered $120,000,000 in assets, whereas the creditors still would have suffered a $30,000,000 loss. The claims did not converge just because 3dfx failed.

To obfuscate this distinction, Respondents quote one passage of the Ninth Circuit opinion stating that Carlyle's complaint alleged an injury to 3dfx. However, in dismissing Carlyle's complaint for lack of standing under *Folks*, both the Ninth Circuit and the District Court also determined that Carlyle's complaint alleged injuries that are general to all creditors (even though only Carlyle was entitled to bring claims against nVidia for interference with or assumption of its lease). *See* Pet. App. 6 ("The district court did not err by relying on *In re Folks*, 211 B.R. 378 (B.A.P. 9th Cir. 1997), because it is consistent with *Smith* and our other decisions on trustee standing."); Pet. App. 27 ("the rule of *In re Folks* that the trustee has exclusive jurisdiction to assert claims where 'liability is to all creditors of the corporation' bars Carlyle"); nVidia Resp. App. 4 ("the law of the Ninth Circuit requires that this Court dismiss the general claims in the TAC for lack of standing"); nVidia Resp. App. 10 ("the rule of *In re Folks* that the trustee has exclusive jurisdiction to assert claims where 'liability is to all creditors of the corporation' bars Carlyle from asserting a claim for breach of fiduciary duty against the 3dfx Defendants").

### C. The 3dfx Ds&Os Misrepresent The Record

The 3dfx Ds&Os claim that the split of authority among the circuits as to standing is irrelevant because "[n]either petitioner, nor any other creditor,

objected to the proposed settlement" between the Trustee and the 3dfx Ds&Os which purportedly released "any liability" of the 3dfx Ds&Os to Carlyle and other creditors.

The 3dfx Ds&Os misstate the record. In response to the 3dfx Ds&Os' motion to have their settlement agreement with the Trustee (which contained an overly broad release) approved by the Bankruptcy Court, on November 4, 2004, **Carlyle filed a written opposition** seeking clarification that "the Trustee is only releasing the Estate's claims, not individual claims of Carlyle, CarrAmerica or other creditors. . . ." (*In re 3dfx*, United States Bankruptcy Court for the Northern District of California Case No. 02-55795, Docket No. 487.) In response to Carlyle's opposition, the Bankruptcy Court stated on the record, which was incorporated by reference into the order approving the settlement, that:

> THE COURT: . . . Lastly, there's the provision about the mutual releases and the language dealing with cause of action or claims that the trustee owns or has the power to release. . . . **[T]he trustee either owns the claim or he doesn't**. He either has the power to release or he doesn't. It's not a legal question. **It's not something that can be conveyed by contract.**

(Transcript of November 9, 2004 hearing; *see also* Petitioner's Ninth Circuit Excerpts of Record, Tab 25, p. 1564.)

On December 15, 2004, approximately one month after the Bankruptcy Court approved the settlement between the Trustee and the 3dfx Ds&Os, the Bankruptcy Court entered an Order granting Carlyle "immediate relief from the automatic stay to pursue the Carlyle D&O Claims . . . against the 3dfx Executives and recover thereon from such Policy. . . ." (Case No. 02-55795, Docket No. 520; *see also* Petitioner's Ninth Circuit Excerpts of Record, Tab 15, p. 0740.) Obviously, in entering the order approving the settlement agreement between the 3dfx Ds&Os and the Trustee, the Bankruptcy Court did not release Carlyle's claims. To the contrary, the Bankruptcy Court granted Carlyle relief from stay to pursue its claims against the 3dfx Ds&Os.

## II. REVIEW IS NECESSARY TO RESOLVE INTER-CIRCUIT CONFLICTS REGARDING THE APPLICATION OF THE *WAGONER* RULE

Respondents claim there is no split in the circuits regarding the application of the *Wagoner* rule. Instead, they argue that "state law differences account entirely for the different results." As shown below, Respondents are mistaken.

When the directors and officers of a corporation cooperate and conspire with a third party to defraud the creditors of the corporation, the corporation is *in pari delicto* with the third party. While the applicability of the *in pari delicto* doctrine may be a matter

of state law,[1] whether a trustee in bankruptcy has **standing** to pursue claims against a third party which is *in pari delicto* with the debtor is a matter of federal bankruptcy law. *Caplin*, 406 U.S. at 429-30 ("Assuming that petitioner's allegations of misconduct on the part of the indenture trustee are true, petitioner has at most described a situation where Webb & Knapp and Marine were *in pari delicto*."); *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114, 118 (2nd Cir. 1991) ("**Under the Bankruptcy Code** the **trustee** stands in the shoes of the bankrupt corporation and **has standing** to bring any suit that the bankrupt corporation could have instituted had it not petitioned for bankruptcy.") (citing 11 U.S.C. §§ 541, 542 and *Caplin*, 406 U.S. at 429); *Bankruptcy Services, Inc. v. Ernst & Young (In re CBI Holding Co.)*, 529 F.3d 432, 454 (2d Cir. 2008) ("**Federal bankruptcy law** 'places a trustee in the shoes of the bankrupt corporation and **affords the trustee standing** to assert any claims that the corporation could have instituted prior to filing its petition for bankruptcy.' ").

The Ninth Circuit acknowledged the inter-circuit conflict regarding the *Wagoner* rule in the opinion

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[1] Regardless of any differences in state law relating to the application of the *in pari delicto* doctrine (and the Ninth Circuit below did not find any), such differences are irrelevant because Carlyle alleged that 3dfx and nVidia conspired to defraud the creditors of 3dfx and were therefore *in pari delicto*. Such allegations must be accepted as true for purposes of a Rule 12(b)(6) motion to dismiss.

below. Pet. App. 7. In declining to follow the Second Circuit, the Ninth Circuit relied on *In re Senior Cottages of America, LLC*, 482 F.3d 997, 1003-04 (8th Cir. 2007), which identified the Court of Appeal opinions that criticize and decline to follow *Wagoner*. Contrary to Respondents' suggestion, the Ninth Circuit did not rely on any purported differences between New York and California state law.[2]

Respondents cite *Peregrine Funding, Inc. v. Sheppard Mullin Richter & Hampton LLP*, 133 Cal. App. 4th 658, 677 (2005), to argue that California state law treats the *in pari delicto* doctrine as an affirmative defense rather than as an issue of standing. However, the California Court of Appeal in *Peregrine* was **interpreting federal bankruptcy law**, not California state law. *Id.* ("Although some cases have considered the bankrupt entity's unclean hands (generally referred to in **federal decisions** as the *in pari delicto* doctrine) as an element of standing (*see, e.g.*, *Apostolou v. Fisher* (N.D.Ill. 1995) 188 B.R. 958, 972), they are analytically distinct concepts. (*See Official Com. of Unsecured Creditors v. R.F. Lafferty & Co., Inc.* (3d Cir. 2001) 267 F.3d 340, 346 (Lafferty)."). Moreover, in *Casey v. U.S. Bank National Ass'n*, the California Court of Appeal interpreted

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[2] nVidia argues that "New York state law conflates the equitable defense of *in pari delicto* with questions of standing, and analyzes the questions together," but fails to cite any New York state law for this proposition.

*Wagoner* as a question of standing. 127 Cal. App. 4th 1138, 1143 (2005) ("denial of standing under *Wagoner* rule depends on 'whether the guilt of the corporate officers can be imputed to the corporation'").

Accordingly, it appears that not only the federal Courts of Appeals but also California state appellate courts are split on how they interpret the *Wagoner* rule.[3]

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[3] Unless the *Wagoner* rule is followed, innocent creditors may lack standing to sue third parties for "defrauding a corporation with the cooperation of management," 944 F.2d at 118, and reorganization trustees may be barred from asserting such claims because the *in pari delicto* doctrine provides a complete defense, thereby precluding any recovery by the creditors or the reorganization trustee against guilty parties who conspire with them. This was precisely the problem that concerned the Supreme Court in *Caplin*. 406 U.S. at 429-30. Given the historic rise in the number of high-profile bankruptcy cases involving Ponzi schemes, it has become especially important for the Supreme Court to address the split of authority regarding the *Wagoner* rule. *Study: Securities litigation on the rise*, DAYTON BUS. J., Apr. 15, 2009 ("The study shows that the Securities and Exchange Commission and U.S. Department of Justice had an unprecedented number of Ponzi schemes on their radar last year."); Ed Duggan, *Madoff fallout promises to spark litigation*, TAMPA BAY BUS. J., Dec. 16, 2008 ("There are defenses to the clawback, including one that may become very familiar to the legal community before the Madoff litigation is over: *in pari delicto*, or the doctrine of equal fault.").

## III. WHETHER A REORGANIZATION TRUSTEE HAS STANDING TO PURSUE A LANDLORD-CREDITOR'S DAMAGES IN EXCESS OF THE "CAP" IS AN ISSUE OF FIRST IMPRESSION

Respondents admit that whether or not a reorganization trustee or the landlord-creditor would have standing to pursue lease damages in excess of the "cap" imposed by 11 U.S.C. § 502(b)(6) is an issue of first impression before the federal courts, but argue that it is "not the sort of earth-shattering issue" which justifies granting certiorari. Determining whether the "cap" bars a landlord-creditor's claims against a solvent, multi-billion dollar third party like nVidia will have far-reaching effects in this unprecedented downturn in the commercial real estate and leasing market (*e.g.*, the recent bankruptcy filing of General Growth Properties Inc. – the largest real estate restructuring and real estate Chapter 11 case in the history of this country).

## IV. REVIEW IS NECESSARY TO DETERMINE WHETHER THE NINTH CIRCUIT COMMITTED PLAIN ERROR IN FINDING THAT E-MAILS CANNOT SATISFY THE STATUTE OF FRAUDS

Respondents claim that whether or not the Ninth Circuit erred in finding that E-mails cannot satisfy the statute of frauds is a state law question which is "the antithesis of a cert.-worthy issue." While the United States Supreme Court ordinarily defers to

lower courts' interpretation of state statutes, the Supreme Court is "particularly reluctant to defer when the lower courts have fallen into plain error. . . ." *Frisby v. Schultz*, 487 U.S. 474, 483 (1988). Given that the courts below dismissed Carlyle's complaint with prejudice as a matter of pleading under Rule 12(b)(6) of the Federal Rules of Civil Procedure based on the defense of the statute of frauds **without an opportunity to amend**,[4] this appeal involves not only a matter of "plain error" but also a matter of fundamental due process.

## CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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[4] The statute of frauds became an issue only with respect to Carlyle's Fourth Amended Complaint and was never an issue with respect to Carlyle's Third Amended Complaint. nVidia Resp. App. 1-14.