

# SMU Annual Texas Survey

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Volume 1

Article 3

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2014

## Bankruptcy

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### Recommended Citation

Joseph J. Wielebiwski & Davor Rukavina, *Bankruptcy*, 1 SMU ANN. TEX. SURV. (2014)  
<https://scholar.smu.edu/smuatxs/vol1/iss1/3>

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# BANKRUPTCY

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## I. INTRODUCTION

This has been one of the most important periods for bankruptcy law developments since the authors began writing for the Survey. On the one hand, the Fifth Circuit decided several important cases of particular importance to Chapter 11: *Village at Camp Bowie*, *Texas Grand Prairie Hotel Realty*, and *MPF Holdings*, among others. These cases, whether one agrees or disagrees with the results, stand for the proposition that bankruptcy is equitable and flexible and that, within the confines of the law, the bankruptcy courts should have sufficient equitable discretion to arrive at appropriate results. In other words, the days of the Fifth Circuit attempting to tell the bankruptcy courts how to decide cases by a talismanic approach appear to be coming to an end.

On the other hand, the Fifth Circuit issued several opinions that threaten the very structure of the Bankruptcy Code. In two opinions, the Fifth Circuit held that parties may not consent to the entry of a final order in a non-core proceeding. Although this issue is presently before the Supreme Court and will likely be decided prior to the publication of this Survey (or shortly thereafter), the inability to consent to final orders severely curtails the ability of the bankruptcy court to function as a centralized forum for adjudicating all estate disputes. Separately, the Fifth Circuit severely curtailed the power of section 1146(c) of the Code by holding that service of a proposed plan is insufficient to strip a secured creditor of his lien, if the secured creditor has not actively participated in the case (such as by filing a claim). Thus, even as the Fifth Circuit continues its pro-equitable approach with respect to deciding the merits of a case, it continues to threaten or to remove from bankruptcy courts the very tools that enable the process to function properly.

Lower courts have not seen much activity due to the general slowdown in bankruptcy filings. As a result, they published few bankruptcy opinions of particular note. However, even if the slowdown continues into the foreseeable future (which the authors do not believe will be the case), future Survey periods are likely to see a large volume of lower court opinions as bankruptcy courts will continue to struggle with interpreting and applying the changes to their fundamental structure in the wake of *Stern v. Marshall* and its progeny.

## II. CHAPTER 11 PLANS

A. ABSOLUTE PRIORITY RULE INDIVIDUAL CASES—*IN RE LIVELY*<sup>1</sup>

Practitioners know that the absolute priority rule, applicable on cramdown, prohibits any junior class from receiving or retaining anything under a Chapter 11 plan unless a senior class accepts the plan or is satisfied in full. In the wake of the 2005 amendments, the question is how the absolute priority rule applies in an individual Chapter 11 case.<sup>2</sup> The Fifth Circuit addressed the question in *In re Lively*. The first problem is that the Circuit Court had to address the issue at all—this is another opinion resulting from sloppy drafting in the 2005 amendments which took a (mostly) pristine and internally consistent Code and slapped a hodgepodge of special interest “fixes” to perceived “problems,” which resulted in more problems for the courts to work through.

The debtor’s Chapter 13 case was converted to Chapter 11 because a creditor filed a claim large enough to disqualify the debtor from Chapter 13 relief.<sup>3</sup> The debtor proposed a plan that retained ownership of various assets, and paid the unsecured creditors a small dividend, but one that *exceeded* the liquidation value of the debtor’s assets.<sup>4</sup> The unsecured class rejected the plan, and the issue was whether the absolute priority rule applies in an individual Chapter 11 case. The more precise issue was the scope of the exception to the absolute priority rule for individuals as a result of the 2005 amendments.

Specifically, the amendment provides that

The holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property; except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115.<sup>5</sup>

The ambiguity arises from the reference to section 1115: section 1115 brings into the estate not only the property that existed as of the petition date and is property of the estate under section 541(a) of the Code, but it also brings into the estate that property acquired postpetition. Thus, does the exception apply to all property of the estate, or only to that property of the estate acquired postpetition?

The Circuit Court, through Judge Edith Jones, held that the exception applies only to postpetition property, such that the debtor may be able to retain property acquired postpetition but not property held as of the petition date.<sup>6</sup> The court appeared to agree that the amendment is ambiguous (though it did not expressly so hold) and that its legislative history is “unenlightening.”<sup>7</sup> The

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1. *In re Lively*, 717 F.3d 406 (5th Cir. 2013).

2. See 11 U.S.C. § 101.

3. See *In re Lively*, 717 F.3d at 407.

4. See *id.*

5. *Id.* at 408 (quoting 11 U.S.C. § 1129(b)(2)(B)(ii)).

6. See *id.* at 409.

7. *Id.* at 408.

Circuit Court nevertheless applied statutory interpretation guides and concluded that limiting the amendment to postpetition property would be unambiguous and correct while adopting the alternative would have the effect of repealing by implication the absolute priority rule for individual debtors.<sup>8</sup> The second point (repeal by implication) was correctly noted by the court and its logic is correct—reading the amendment broadly would effectively repeal the absolute priority rule for individuals.

But, perhaps this is precisely what Congress intended: there is no absolute priority rule in Chapter 13, and the amendment, appearing in section 1129(b)(2)(B)(ii) of the Code, applies to both corporate and individual debtors.<sup>9</sup> In other words, it would be odd indeed for Congress to insert an exception to the absolute priority rule if Congress intended to repeal the absolute priority rule. If the amendment applied solely to an individual case, then that would be the effect and the Circuit's logic would be correct (Congress would hardly be providing an exception to something that it intended to write out of the Code). But, because the amendment applies to both corporate and individual cases, it is just as logical to conclude that Congress' precise intention was to repeal the absolute priority rule *in toto* in individual cases, while retaining it for corporate debtors. The language may be less than perfect, but that is only because Congress inserted the language into an existing global subsection of the statute, instead of having a separate subsection of the statute applicable only to individuals. What is more logical and what leads to a less absurd result: that Congress intended to repeal the absolute priority rule *in toto* for Chapter 11 debtors, as is the case for Chapter 13, or that Congress intended to repeal the absolute priority rule just in part, such that non-exempt postpetition property could be retained but prepetition non-exempt property could not?

The result is that, without consent of unsecured creditors, the debtor must liquidate property and pay them *less* than what they would receive in liquidation, because the circuit concluded that the plan offered the unsecured creditors more than a liquidation. This is absurd. True, one may say that this is the same result in a corporate Chapter 11 case, and that there is therefore nothing absurd about the result. And true, it may be unfair for a debtor to retain non-exempt property when his creditors are not being paid in full. But the question is still the value of that property, and if the creditors receive more as a result of the debtor keeping the property, instead of liquidating it, then the result is indeed absurd. Also, in an individual Chapter 11 case, where an unsecured creditor objects to confirmation, the debtor is required to provide value equal to the claim or to pay over his projected disposable income for five years or more following confirmation.<sup>10</sup>

The court could just as easily have ruled the other way without violating statutory construction principles and without doing violence to the Code. The amendment states that “the debtor may retain property included in the estate under section 1115.”<sup>11</sup> The amendment does not state that “the debtor may

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8. *Id.* at 409.

9. See 11 U.S.C. § 1129(b)(2)(B)(ii).

10. See 11 U.S.C. § 1129(a)(15).

11. 11 U.S.C. § 1129(b)(2)(B)(ii).

retain property included in the estate *only* under section 1115,” or “included in the estate *by* section 1115.” Section 1115 provides that property of the estate, in Chapter 11, “includes, in addition to the property specified in section 541 . . . .”<sup>12</sup> Thus, even a simple reading of section 1115 demonstrates that it says two things: property of the estate in Chapter 11 includes prepetition property and postpetition property. Reading the word “included” as a verb i.e., that section 1115 must be doing the inclusion of property itself for the amendment to apply—as the circuit did—does not change the result because section 1115 “includes” property of the estate with respect to prepetition property as well as postpetition property.

More than anything, though, if the purpose of the amendment was to make an individual Chapter 11 plan function more like a Chapter 13 plan—as the court noted it was—then why would a Chapter 11 individual debtor not be permitted to retain non-exempt property, provided that the best interests and disposable income tests are satisfied, when his Chapter 13 cousin would be permitted to retain such property? The Circuit Court may well be correct on a technical reading of the statute. But the statute is part of a comprehensive overall statutory scheme and must be read in that light and with the fundamental policies underpinning the Code in mind. It is also odd for the Fifth Circuit to rest on a technical application of the statute, when at the same time it applies judicial gloss that perpetrates substantial violence on other clear statutory provisions (such as 1146(c) discussed in this Survey and the ability to consent to a judgment in non-core proceedings). It is even odder that, as a result of this opinion, the debtor cannot reorganize unless the debtor surrenders non-exempt property, and if the debtor does so, unsecured creditors might actually receive less than they would under the plan.

Yet the oddest thing about the *Lively* decision is the very logic employed by the Circuit Court. According to the court, the amendments addressed the inequitable result that an individual Chapter 11 debtor, prior to the amendments, would have to account to his creditors only for property as of the petition date, and could keep postpetition property to himself: “[b]efore the BAPCPA [Bankruptcy Abuse Prevention and Consume Protection Act] amendments, however, an individual Chapter 11 debtor would only have to satisfy the absolute priority rule with assets that were ‘property of the estate’ at the date of filing for relief; the individual debtor’s personal post-petition earnings were not subject to liability to satisfy his creditors.”<sup>13</sup> The amendments “remedied this potential inequity in Chapter 11 by adding to the § 541 definition the individual debtor’s post-petition earnings and property acquisitions.”<sup>14</sup> This is certainly correct, but what then is the ultimate result under *Lively*? Congress intended that a debtor’s postpetition assets be available to satisfy creditors, yet under *Lively*, those are precisely the assets that a debtor can shield against the effects of the absolute priority rule. The circuit noted an ambiguity, the circuit applied standard statutory interpretation guides, and the circuit may even have struggled with the analysis to reach its conclusion. While

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12. 11 U.S.C. § 1115(a).

13. *Lively*, 717 F.3d at 409.

14. *Id.*

its answer may be technically correct, the result is absurd and inequitable to debtors *and* to creditors. That should have been the beginning and the end of inquiry.

The authors have devoted considerable discussion to this opinion because they do not believe that this opinion is consistent with the Code or its policies, and they hope that their views may help a future litigant convince the courts that the result should be overturned.

#### B. ARTIFICIAL IMPAIRMENT—VILLAGE AT CAMP BOWIE<sup>15</sup>

In order to confirm a plan on cramdown of a class of creditors, at least one *impaired* class of non-insider creditors must accept the plan.<sup>16</sup> What happens when the debtor has enough funds to pay unsecured creditors in full at confirmation, as is seen in some real estate cases where there may be one large secured creditor with a large deficiency (i.e., unsecured claim), along with multiple minor unsecured creditors whose claims can be easily paid? Classification issues aside, may the debtor artificially impair a class—in other words, not pay the class in full right away even though the debtor could do so—in order to obtain an impaired class for voting and cramdown purposes? As discussed in the prior Survey, Judge D. Michael Lynn of the Bankruptcy Court for the Northern District of Texas held that the debtor could artificially impair a class of creditors, in certain situations.<sup>17</sup> On direct appeal, the Fifth Circuit affirmed.

The case involved real estate, rather typical of many of the recent Chapter 11 filings, where the debtor leased commercial property.<sup>18</sup> The debtor had one large secured creditor, and numerous small trade creditors.<sup>19</sup> The plan classified thirty-eight trade creditors, proposed to pay them in full within three months of confirmation, and the class voted for the plan.<sup>20</sup> The secured creditor objected, arguing that the debtor had artificially impaired the trade creditors because: (i) the slight delay in payment was not true impairment; and (ii) the debtor could pay the trade creditors in full and delayed their payment only to engineer an impaired class.<sup>21</sup> To its credit, the debtor admitted at the confirmation hearing that it could pay the class in full, but that it intentionally impaired the class for cramdown purposes.

The court noted that “[c]ircuits have divided over the question of whether § 1129(a)(10) draws a distinction between artificial and economically driven impairment.”<sup>22</sup> The Circuit Court also noted that, while its prior precedent was unclear on the issue, it had voiced concern over artificial impairment and had remanded a case to the bankruptcy court to consider the issue in light of the

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15. *Western Real Estate Equities, L.L.C. v. Village at Camp Bowie I, L.P.* (*In re Village at Camp Bowie I, L.P.*), 710 F.3d 239 (5th Cir. 2013).

16. *See* 11 U.S.C. § 1129(a)(10).

17. *In re Village at Camp Bowie I, L.P.*, 454 B.R. 702 (Bankr. N.D. Tex. 2011).

18. *In re Village at Camp Bowie I, L.P.*, 710 F.3d at 242.

19. *Id.* at 243.

20. *See id.*

21. *Id.* at 243.

22. *Id.* at 244.

good faith requirement under section 1129(a) of the Code.<sup>23</sup> Nevertheless, the Fifth Circuit rejected the *Windsor* precedent from the Eighth Circuit that prohibited artificial impairment:

We expressly reject *Windsor* . . . § 1129(a)(10) does not distinguish between discretionary and economically driven impairment . . . § 1124 provides that any alteration of a creditor's rights, no matter how minor, constitutes 'impairment.' By shoehorning a motive inquiry and materiality requirement into § 1129(a)(10), *Windsor* warps the text of the Code, requiring a court to 'deem' a claim unimpaired for purposes of § 1129(a)(10) even though it plainly qualifies as impaired under § 1124. *Windsor*'s motive inquiry is also inconsistent with § 1123(b)(1), which provides that a plan proponent may impair or leave unimpaired any class of claims, and does not contain any indication that impairment must be driven by economic motives.<sup>24</sup>

Addressing the lender's argument that this was akin to the same kind of gerrymandering prohibited by *Greystone*, the circuit rejected the argument that *Greystone* prohibits all "voting manipulation."<sup>25</sup> Rather, *Greystone* addressed an ambiguity created by section 1122 of the Code, but it did not "stand for the proposition that a court can ride roughshod over affirmative language in the Bankruptcy Code to enforce some Platonic ideal of a fair voting process."<sup>26</sup>

The overall issue is good faith under the Code and the requirement that the plan not be forbidden by law.<sup>27</sup>

Good faith should be evaluated in light of the totality of the circumstances surrounding establishment of the plan, mindful of the purposes underlying the Bankruptcy Code. Generally, where a plan is proposed with the legitimate and honest purpose to reorganize and has a reasonable hope of success, the good faith requirement of § 1129(a)(3) is satisfied.<sup>28</sup>

As the court noted, the bankruptcy court found good faith and that finding was not error: the debtor proposed a feasible plan that would allow it to repay its debts, to preserve equity, and to stay current under its plan.<sup>29</sup> As is discussed in greater detail in Judge Lynn's opinion, the plan pays the lender in full, while the lender purchased its claim for a discount and was contesting the plan in order to gain control over the collateral and have the benefit of the equity in the collateral.<sup>30</sup> In other words, and although unspoken by the courts, the debtor was free to resort to reasonable tactics to contest the lender's questionable motives.

The Fifth Circuit cautioned, however, that its opinion was not a blank check

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23. See *id.* at 245.

24. *Id.* at 245-46 (internal citations and quotations omitted).

25. *Id.* at 247.

26. *Id.*

27. See *id.*

28. *Id.* (internal quotations omitted).

29. See *id.* at 247-48.

30. See *In re Village at Camp Bowie I, L.P.*, 454 B.R. at 709-10.



to manipulate the Code or the progress:

We do not suggest that a debtor's methods for achieving literal compliance with § 1129(a)(10) enjoy a free pass from scrutiny under § 1129(a)(3). . . . An inference of bad faith might be stronger where a debtor creates an impaired accepting class out of whole cloth by incurring a debt with a related party. . . . Ultimately, the § 1129(a)(3) inquiry is fact-specific, fully empowering the bankruptcy courts to deal with chicanery. We will continue to accord deference to their determinations.<sup>31</sup>

This is perhaps the broader import of *In re Village at Camp Bowie*: bankruptcy relief is equitable in nature and often fact specific, and, while the debtor was permitted to artificially impair in this case, it is for the bankruptcy court to weigh all of the facts and circumstances of a particular case and the bankruptcy court's decision will be entitled to deference. The circuit's conclusion was substantially the same in *Texas Grand Prairie Hotel Realty*, discussed below. And, it is no coincidence that Judge Higginbotham authored both opinions.

#### C. CRAMDOWN INTEREST RATE SECURED CLAIMS—TEXAS GRAND PRAIRIE HOTEL REALTY

For the first time in decades, and for the first time since the Supreme Court's *Till*<sup>32</sup> opinion, the Fifth Circuit reviewed the issue of the appropriate cramdown rate of interest on a secured claim in a Chapter 11 plan, in *Texas Grand Prairie Hotel Realty, LLC*.<sup>33</sup>

The plan, covering four Hyatt Place hotels, provided for a 5% interest rate to the secured lender. Because no agreement could be reached with the lender, the plan proceeded on cramdown. Of note, the 5% rate was more than twice the contract rate (the contract rate being a London Interbank Offered Rate (LIBOR) based rate), 1.75% more than the Prime Rate, and almost twice the Treasury Bill rate. The lender, using the market rate approach, advocated a rate of 8.8%. Both the debtors and the lender argued that *Till*, while not controlling (as it was a Chapter 13 case), provided persuasive guidance on the cramdown rate issue. Thus, the case came down to what methodology should apply to calculate the cramdown rate: must one methodology apply in Chapter 11 and, if so, must it be the market rate of interest?

In *Till*, the Supreme Court adopted the "formula" approach and held that, for Chapter 13 at least, the cramdown interest rate should start with a benchmark, the Prime Rate, and then be adjusted upward based on risk, usually within a 1–3% interest adjustment range. Any higher adjustment could raise serious concerns regarding feasibility, and denial of confirmation based on feasibility would probably be the result. However, in *Till*, the Supreme Court stated in a footnote that, in Chapter 11, it may make sense to look at the rate

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31. *In re Village at Camp Bowie I, L.P.*, 710 F.3d at 248.

32. *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004).

33. *Wells Fargo N.A. v. Texas Grand Prairie Hotel Realty, L.L.C.* (*In re Texas Grand Prairie Hotel Realty, L.L.C.*), 710 F.3d 324 (5th Cir. 2013).

that the market would charge, if there is an efficient market.<sup>34</sup> This led to substantial dispute as to what was meant by the Court, if anything. One circuit, for example, concluded that the market rate must apply if there is an efficient market.<sup>35</sup> Prior to *Till*, the Fifth Circuit had not adopted any particular methodology, although it had held that the appropriate rate should factor in a risk component, and it affirmed rates based loosely on the contract rate or the Treasury Bill rate.<sup>36</sup>

The market rate approach advocated by the lender in *Texas Grand Prairie Realty, L.L.C.* was as follows. The lender's expert looked to the loan-to-values ratio of the cramdown loan, noted that no single lender would be willing to extend such a loan, and then broke the loan out into three tranches based on differing loan-to-value and therefore risk.<sup>37</sup> Each tranche was priced separately based on the risk, with the last tranche being the return expected of equity, or 22%.<sup>38</sup> The expert then blended the rates on the three tranches to arrive at his 8.8% rate.<sup>39</sup> Not surprisingly, this rate could not be sustained by the debtors or by the lender's collateral, and would have defeated the plan based on feasibility. This methodology is familiar to debtor's counsel, as one that always leads to the highest rate and whose purpose is not to arrive at a reasonable rate, but a rate that defeats any otherwise feasible plan. Lender's counsel would probably disagree, but it is hard to refute that this approach always leads to the highest rate. While the lender based its methodology on the famous *Till* footnote, the fact was that even the lender's expert agreed that no efficient market existed for the cramdown loan.

The debtors' expert, on the other hand, applied *Till* by beginning with the Prime Rate, 3.5%, and then adjusted upward by 1.75% to account for the various factors identified in *Till*, including the circumstances of the bankruptcy case, the quality of the collateral, management, operations, and others.<sup>40</sup> The lender argued that this was a "holistic" approach that could not be reproduced objectively by a different expert; in other words, that it was purely subjective and a number picked from thin air. Yet, if that is true, then that is exactly what *Till* provides for. Moreover, the other identified approaches, including the contract rate and the Treasury Bill benchmark approach, would have led to a rate even lower than 5%. Thus, although the lender complained that the 5% rate was too low, it was more than contract and more than other identified cramdown rate methodologies.

The Fifth Circuit first addressed the lender's argument that, although the

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34. *Till*, 541 U.S. at 503 n.20.

35. *Bank of Montreal v. Official Comm. of Unsecured Creditors (In re American Homepatient Inc.)*, 420 F.3d 559, 568 (6th Cir. 2005).

36. *Fin. Sec. Assurance Inc. v. T-H New Orleans Ltd. P'ship (In re T-H New Orleans Ltd. P'ship)*, 116 F.3d 790, 800 (5th Cir. 1997); *Heartland Fed. Sav. & Loan Ass'n v. Briscoe Enters. Ltd., II (In re Briscoe Enters. Ltd., II)*, 994 F.2d 1160, 1169 (5th Cir. 1993).

37. See Brief of Appellant at 18, *In re Texas Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d 324 (2013).

38. *Id.*

39. *Id.*

40. See Brief of Appellees at 49, *In re Texas Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d 324 (2013).

bankruptcy court's overall findings are questions of fact, the choice of which cramdown rate methodology to apply was a question of law, and that the circuit should adopt the market rate approach as the appropriate methodology.<sup>41</sup> The circuit rejected this invitation, reiterating its prior precedent to the effect that it would not "tie the hands of the lower courts as they make the factual determination involved in establishing an appropriate interest rate."<sup>42</sup> Thus, the Circuit "declined to establish a particular formula for the cramdown interest rate in Chapter 11 cases."<sup>43</sup> These holdings drove the balance of the analysis: because the overall issue was one of fact, and because no particular methodology for determining the appropriate rate was required, the bankruptcy court did not commit clear error in finding the debtors' formula approach more appropriate for the circumstances than the lender's market approach. Thus, the *Till* approach was an appropriate approach for the Chapter 11 cramdown rate:

A bankruptcy court should begin its cramdown rate analysis with the national prime rate—the rate charged by banks to creditworthy commercial borrowers—and then add a supplemental risk adjustment to account for such factors as the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan. Though the plurality did not decide the proper scale for the risk adjustment, it observed that other courts have generally approved adjustments of 1% to 3%.<sup>44</sup>

The court also noted that the lender's expert's method was incompatible with *Till*, because the expert did not begin with the Prime Rate, but rather with the market rate. The circuit also quoted the bankruptcy court's reasoning (Bankruptcy Judge Russell F. Nelms of the Northern District of Texas):

I disagree with [the lender's] approach because it establishes a benchmark before adjustment that I just view to be completely inconsistent with *Till*. *Till* set that benchmark at national prime, but according to [the lender], you first determine what level any portion of a loan would be financeable, and then you begin to work from there. The Court finds no support for that type of analysis in *Till*. If anything this strikes the Court as more in the nature of a forced loan approach that the majority in *Till* expressly rejected.<sup>45</sup>

Importantly, just as the Fifth Circuit refused to adopt the market rate approach as the only permissible approach, the court did not adopt the *Till* approach as the only permissible approach or even the optimal approach.<sup>46</sup> Rather, it was for the bankruptcy court to apply the appropriate methodology to the facts, and applying the *Till* formula approach for this case—especially where there was no efficient market—was not clear error. Therein lies the importance

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41. *In re Texas Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d at 330.

42. *Id.* (internal quotation omitted).

43. *Id.* at 330-31.

44. *Id.* at 331 (internal quotations omitted).

45. *Id.* at 335.

46. *See id.* at 337.

of *Texas Grand Prairie Hotel Realty*: not necessarily the result, or an (arguably) debtor friendly approach, or even the approval of the *Till* approach, but rather the rejection of any specific approach as governing, thereby confirming and enabling the equitable nature and functioning of the bankruptcy court (after years, it seems, of the circuit trying to tell bankruptcy courts how they should decide cases as a matter of law, as opposed to a matter of fact and of equity).

Together the Fifth Circuit's rulings on *Texas Grand Prairie Hotel* and *Camp Bowie*, have once again made Chapter 11 secured creditor cramdown a viable option, which will serve to ensure that secured creditors have a downside to confirmation, thus motivating them to work reasonably towards the consensual resolution that Chapter 11 strives to achieve. These opinions, more than anything, have again leveled the confirmation playing field in the Fifth Circuit.

D. CRAMDOWN INTEREST RATE UNSECURED CLAIMS—*IN RE TEXAS STAR REFRESHMENTS*<sup>47</sup>

Few recent opinions consider the appropriate rate of interest that must be paid to an unsecured class being crammed down in Chapter 11. Judge Jones, of the Bankruptcy Court for the Northern District of Texas, considered this issue in *In re Texas Star Refreshments L.L.C.*, all the more relevant because he did so in light of the Fifth Circuit's *Texas Grand Prairie Hotel Realty* opinion.

The debtor's plan separately classified a large unsecured creditor, who rejected the plan. The plan proposed an interest rate of 5% to the unsecured creditor, and that rate provided for a prepetition judgment against the debtor pursuant to separate law. The issue was whether the 5% rate to the unsecured creditor complied with the "fair and equitable" requirement to cramdown an unsecured class. In the process, the opinion attempts to address one of the arguments made against the Prime-plus approach approved of by the Fifth Circuit in *Texas Grand Prairie Hotel Realty*. One of the arguments against the result in *Texas Grand Prairie Hotel Realty* is that it leads to an absurd result where a secured creditor is paid an interest rate that is lower than what the market would have charged for a well collateralized, fully secured, credit worthy loan. In *In re Texas Star Refreshments L.L.C.*, the unsecured class would receive a lower interest rate under the plan than the secured class, even though the risk of nonpayment under the plan was clearly higher. If the interest rate is meant to compensate for the risk of nonpayment, then the unsecured creditor should arguably receive a higher rate, according to the creditor's argument. The court addressed this issue as follows:

At first blush it appears that an unsecured creditor should receive a higher interest rate than a secured creditor, given the risk of non-payment. This analysis fails, however, when the relative risks of liquidation and confirmation are considered. A secured creditor's risk may increase given a debtor's continued use of the creditor's collateral. An unsecured creditor's prospects of repayment may indeed be enhanced if the debtor survives and the only other real alternative is liquidation. Such is the case here. If the TSR Plan fails, liquidation is likely with First Bank foreclosing its liens. Unsecured creditors, and specifically CFG, will receive no dividend on

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47. *In re Texas Star Refreshments L.L.C.*, 494 B.R. 684 (Bankr. N.D. Tex. 2013).

account of their claims. The risk that CFG will not be repaid is far greater upon liquidation. CFG did not bargain for a 5% rate, but there is clearly no market for a \$900,000+ unsecured loan to an insolvent company. While there is arguably a risk component required for any present value analysis, there is no clear standard for setting the proper rate.<sup>48</sup>

Accordingly, the court applied the *Till* formula approach and the rationale of *Texas Grand Prairie Hotel Realty* to the cramdown of an unsecured creditor, resulting in the approval of the 5% rate to unsecured creditors. Of note, the Bankruptcy Court for the Western District of Texas soon thereafter arrived at the same conclusion, and applied the formula approach to an unsecured, deficiency claim.<sup>49</sup>

E. CRAMDOWN SALES AND INDUBITABLE EQUIVALENT—*RADLAX GATEWAY HOTEL LLC*<sup>50</sup>

Is a cramdown sale that seeks to take away the secured creditor's credit bid rights subject to the indubitable equivalent standard or to the cramdown sale standard? The Supreme Court considered this issue in *RadLAX Gateway Hotel LLC v. Amalgamated Bank*.

The debtor proposed a cramdown sale of the lender's collateral, a hotel and associated commercial realty, free and clear of the lender's liens.<sup>51</sup> With the same, the debtor sought the approval of auction and bid procedures that denied the lender its credit bid rights under section 363(k) of the Code.<sup>52</sup> This directly violated section 1129(b)(2)(A)(ii) of the Code, which provides that a cramdown sale of collateral must be subject to the creditor's credit bid rights. For this reason, the lower courts rejected the bid procedures and the plan. The debtor, however, argued that section 1129(b)(2)(A)(iii) of the Code applied, and that cramdown was possible because the treatment offered was the indubitable equivalent of the lender's claim.<sup>53</sup>

The Supreme Court soundly rejected this argument: “[W]e find the debtors’ reading of § 1129(b)(2)(A)—under which clause (iii) permits precisely what clause (ii) proscribes—to be hyperliteral and contrary to common sense.”<sup>54</sup> Employing established statutory construction, the Court held that the more specific statutory provision—section 1129(b)(2)(A)(ii)—applied, as it was most on point.<sup>55</sup> After all, the plan proposed a sale of the collateral. Although the Court agreed that section 1129(b)(2)(A) provides three distinct and disjunctive avenues for cramdown, the Court simply found that the plan was a sale plan and therefore the cramdown sale provision, and not the indubitable equivalent provision, applies regardless of how the debtor characterizes the cramdown avenue it seeks

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48. *Id.* at 701–02.

49. *See In re LMR, L.L.C.*, 496 B.R. 410 (Bankr. W.D. Tex. 2013).

50. *RadLAX Gateway Hotel LLC v. Amalgamated Bank*, 132 S. Ct. 2065 (2012).

51. *See id.* at 2068–69.

52. *See id.* at 2069–70.

53. *See id.* at 2070.

54. *Id.*

55. *Id.* at 2070–73.

to employ: “[d]ebtors seeking to sell their property free of liens under § 1129(b)(2)(A) must satisfy the requirements of clause (ii), not the requirements of both clauses (ii) and (iii).”<sup>56</sup>

This opinion is important, not only because it clarifies the issue, but also because it effectively reverses the Fifth Circuit’s holding in *In the Matter of Pacific Lumber*, 584 F.3d 229 (5th Cir. 2009). In that opinion, the Circuit held that section 1129(b)(2)(A)(ii) was not the exclusive cramdown avenue for a sale plan, and that credit bid rights could be taken away even in a plan cramdown sale under the indubitable equivalent avenue of section 1129(b)(2)(A)(iii). Practitioners are cautioned not to rely on *Pacific Lumber* if they propose a cramdown sale plan without protecting the lender’s credit bid rights. Practitioners are also reminded that section 363(k) of the Code—which is explicitly referenced in section 1129(b)(2)(A)(ii)—is not absolute. The bankruptcy court has the power under section 363(k) to deny credit bidding.<sup>57</sup> Depending on the facts, it may be that addressing the actual right to credit bid, or asserting that cause exists to deny the same, may be preferable and less risky on appeal than using section 1129(b)(2)(A) to deny credit bidding outright.

### III. CLAIM PRESERVATION (POSTCONFIRMATION STANDING)

#### A. *COMPTON V. ANDERSON (IN RE MPF HOLDINGS US, LLC)*

The authors have discussed multiple opinions addressing claim retention under confirmed plans in prior Surveys. One that they had criticized, together with multiple commentators, was Judge Bohm’s *sua sponte* opinion in *In re MPF Holdings*, from the Bankruptcy Court for the Southern District of Texas.<sup>58</sup> Judge Bohm held that, in order to preserve a cause of action under a Chapter 11 plan under *United Operating*, the plan must specifically name the defendants, set forth the legal basis for the claim, and inform the defendants that they will be sued (not that they might be sued).<sup>59</sup>

As predicted, the Fifth Circuit reversed on direct appeal.<sup>60</sup> The circuit reaffirmed that, under its *United Operating* standard, a plan must “specifically and unequivocally” preserve a cause of action.<sup>61</sup> The Circuit noted that it had clarified the standard in *Texas Wyoming* (issued after Judge Bohm’s opinion), and that *Texas Wyoming* found that avoidance actions were sufficiently preserved even though the plan did not necessarily identify the defendants to be sued postconfirmation.<sup>62</sup> Thus, the court concluded that “the reasons relied upon by the bankruptcy court for finding that the Reorganization Plan did not contain a sufficiently unequivocal reservation are not supported by our case law.”<sup>63</sup>

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56. *Id.* at 2072 (emphasis in original).

57. See 11 U.S.C. § 363(k) (providing that the bankruptcy court may deny credit bidding “for cause”).

58. *In re MPF Holding US, LLC*, 443 B.R. 736 (Bankr. S.D. Tex. 2011).

59. *Id.* at 744.

60. See *Compton v. Anderson (In re MPF Holdings US, LLC)*, 701 F.3d 449 (5th Cir. 2012).

61. *Id.* at 454.

62. See *id.*

63. *Id.* at 457.

The Fifth Circuit's opinion is included in this Survey not because of any new precedent that it establishes, but rather to note that *In re MPF Holdings* has been reversed. Moreover, the opinion continues to recognize, as announced in *Texas Wyoming*, that the "specific and unequivocal" standard is not the talismanic and hyper-technical requirement that some have argued it is, or that it should be.

#### IV. CONSTRUCTIVE TRUST

##### A. *THRASHER V. MANDEL (IN RE MANDEL)*

In *In re Mandel*, Chief Judge Brenda T. Rhoades of the United States Bankruptcy Court for the Eastern District of Texas considered the issue of whether a claim to a constructive trust under Texas law is a "claim" under the Bankruptcy Code that is subject to the bar date.<sup>64</sup> In this case, the creditor obtained allowed claims against the debtor for millions of dollars, including claims for fraud and breach of duty.<sup>65</sup> The creditor timely filed a proof of claim for the allowed claims, but did not assert a constructive trust claim prior to the bar date.<sup>66</sup> Instead, after the bar date and in the middle of a lengthy claims allowance trial, the creditor filed an adversary proceeding seeking to impose a constructive trust against property of the estate alleged to have been the result of the tortious actions. The creditor argued that the constructive trust claim was not a "claim" and that it could only have been asserted by way of adversary proceeding and not by proof of claim.<sup>67</sup>

The court noted that constructive trust is a remedy under Texas law and not a cause of action by itself.<sup>68</sup> The Bankruptcy Code defines "claim" as including a right to an equitable remedy when monetary damages are also available.<sup>69</sup> The constructive trust action, because no constructive trust had been imposed prepetition, was therefore a "claim."<sup>70</sup> The court also acknowledged that a constructive trust conflicts with the Code's priority provisions and fundamental policies, and that a constructive trust should rarely be imposed postpetition.<sup>71</sup>

This is an important opinion. It is difficult to argue with the court's reasoning or conclusion: constructive trust is clearly an equitable remedy for the same causes of action to which monetary damages apply, and the Code clearly defines "claim" as including precisely that remedy. That a constructive trust remedy must be asserted by way of adversary proceeding does not remove it from the bar date: it either must be preserved in a timely proof of claim, or the adversary proceeding must be initiated prior to the bar date. The claim, even if not ripe, is certainly contingent and unliquidated, and all practitioners know that the bar date applies equally to unripe claims as to fully matured ones. This is neither

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64. *Thrasher v. Mandel (In re Mandel)*,—B.R.—, 2013 WL 4829150 (Bankr. E.D. Tex. 2013).

65. *See id.* at \*1-2.

66. *See id.*

67. *See id.* at \*4.

68. *See id.* at \*3.

69. *See* 11 U.S.C. § 101(5).

70. *In re Mandel*, 2013 WL 4829150 at \*2 (the court had previously entered an opinion on the issue, which was not published, but discussed the analysis in greater depth).

71. *See id.* at \*4-5.

unreasonable, unworkable, nor oppressive, and one would think that a debtor, a trustee, and all creditors should know sooner rather than later whether estate assets may be subject to constructive trust, for obvious reasons of planning and reliance. But more than that, constructive trust actions are frequently asserted and lead to substantial burden on litigants, debtors, and bankruptcy courts. Usually, they fail (the authors are not aware of any successful postpetition constructive trust action), but not before they consume substantial resources. Frequently, they are asserted for leverage purposes. The court in *In re Mandel* made it clear that the assertion of such claims, even if possible, will be held to the same strict requirements as all creditors are held to.

## V. DISCHARGE/DISCHARGEABILITY

### A. *BULLOCK V. BANKCHAMPAIGN, N.A.*

Section 523(a)(4) excepts from discharge a debt “for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.”<sup>72</sup> In *Bullock*,<sup>73</sup> the Supreme Court considered the meaning of “defalcation.”

The debtor was a non-professional trustee of a family trust created by his father.<sup>74</sup> Over the years, the debtor borrowed money from the trust to purchase property for himself and his mother.<sup>75</sup> Although the debtor always repaid the funds he borrowed, with interest, his brothers sued him in state court and obtained a judgment for breach of fiduciary duty, although the state court held that the debtor appears to not have had a malicious intent in borrowing the funds (and was instead guilty of self-dealing).<sup>76</sup> In bankruptcy, the replacement trustee sought to deny the debtor’s discharge of his court-ordered debt for defalcation while acting in a fiduciary capacity. The issue before the Court was whether defalcation applies in the absence of any specific ill intent or loss of the trust principal.

The Court began by reviewing the use of “defalcation” in bankruptcies commencing in 1867.<sup>77</sup> The Court noted that there was no clear definition, and that appellate courts had long disagreed about the mental state that must be present for defalcation.<sup>78</sup> Analyzing the term in proximity to the other terms (fraud, embezzlement, larceny), the Court favored an interpretation that would apply similar culpable mental states to defalcation, and the Court noted that exceptions to discharge should be confined to those that are “plainly expressed.”<sup>79</sup> Thus, the Court construed defalcation for purposes of the statute as follows:

Where the conduct at issue does not involve bad faith, moral turpitude, or

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72. 11 U.S.C. § 523(a)(4).

73. *Bullock v. BankChampaign, N.A.*, 133 S. Ct. 1754 (2013).

74. *See id.* at 1757.

75. *See id.*

76. *See id.*

77. *See id.* at 1758.

78. *See id.*

79. *Id.* at 1759–60.



other immoral conduct, the term requires an intentional wrong. We include as intentional not only conduct that the fiduciary knows is improper but also reckless conduct of the kind that the criminal law often treats as the equivalent. . . . Where actual knowledge of wrongdoing is lacking, we consider conduct as equivalent if the fiduciary consciously disregards (or is willfully blind to) a substantial and unjustifiable risk that his conduct will turn out to violate a fiduciary duty. . . . That risk must be of such a nature and degree that, considering the nature and purpose of the actor's conduct and the circumstances known to him, its disregard involves a gross deviation from the standard of conduct that a law-abiding person would observe in the actor's situation.<sup>80</sup>

The Court remanded the matter for further proceedings, reversing the lower courts' "objective recklessness" standard, with instructions to apply the heightened standard.<sup>81</sup>

## VI. EQUITABLE MOOTNESS

### A. *WELLS FARGO N.A. V. TEXAS GRAND PRAIRIE HOTEL REALTY L.L.C. (IN RE TEXAS GRAND PRAIRIE HOTEL REALTY, L.L.C.)*

The authors have discussed at length in prior surveys that the Fifth Circuit has been clamping down on the doctrine of equitable mootness and has made it much harder to obtain dismissal of an appeal based on that doctrine. The Fifth Circuit visited the issue again in *In re Texas Grand Prairie Hotel Realty*, rejecting the application of the doctrine to the facts of the case.<sup>82</sup> The question remaining is: if application of the doctrine was inappropriate in this case, then in which case would it still be appropriate?

The overall issue before the circuit was the cramdown interest rate (as otherwise discussed in this Survey).<sup>83</sup> The debtors argued that the appeal should be dismissed as equitably moot because, granting the lender the much higher interest rate the lender sought would make the plan unfeasible and impossible and would unwind the plan despite many postconfirmation transactions and payments.<sup>84</sup> The debtors had made more than \$8 million in postconfirmation payments to dozens of creditors, including cashing out entire classes under the plan.<sup>85</sup> Additionally, the debtors sold the equity in their company under the plan in exchange for millions of dollars in funding from the new owner (affiliated with the old owner).<sup>86</sup> The debtors argued that it would be impossible to unwind these transactions, recapture payments made to creditors, and compensate the purchaser of new equity for its payments.<sup>87</sup>

The lender, very wisely, did not argue for the undoing of the plan *in toto*.

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80. *Id.* (internal quotations omitted).

81. *Id.* at 1761.

82. See generally *In re Texas Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d 324 (5th Cir. 2013).

83. See *id.* at 326.

84. See *id.* at 328.

85. See *id.*

86. See *id.*

87. See *id.*

Instead, the lender argued that the circuit could reverse and remand in order to increase the cramdown interest rate to the maximum amount that could be borne by the debtors without necessarily unwinding the plan.<sup>88</sup> The debtors responded that their plan was a zero sum game: all future cash flow was devoted to one or another creditor under the plan.<sup>89</sup> Thus, being required to pay the lender greater interest would necessarily mean less funds to pay the other creditors what they were promised under the plan.<sup>90</sup> The circuit rejected this argument, noting that, while the plan projections allocated every dollar to various creditors, actual results might be better.<sup>91</sup> Moreover, during the last two plan years, the debtors projected net operating income of over \$3 million that was not allocated to creditors, and which could be used to compensate the lender in the event a higher interest rate was required but which could not be sustained on a current basis.<sup>92</sup> Thus, “the possibility exists that the Debtors could afford a fractional payout without reducing distributions to third-party claimants.”<sup>93</sup>

One wonders whether the result may have been different had the circuit not otherwise affirmed the bankruptcy court and the 5% rate of interest. Nevertheless, the opinion is significant for two reasons. First, the Fifth Circuit appears willing to try to find any way possible to avoid dismissing an appeal for equitable mootness (as perhaps it should, since dismissing an otherwise meritorious appeal is a harsh remedy). Second, the lender approached the issue appropriately by not contesting (for equitable mootness purposes at least) the confirmation of the plan as a whole, but rather solely the interest rate, and by arguing that even if equitable mootness might prevent the much higher interest rate the lender wanted, there was very likely *some* higher amount of interest that the debtors could pay under their plan.<sup>94</sup> This was the epitome of the saying that “pigs get fat and hogs get slaughtered,” and it worked for the lender. But it cannot be disputed that the net result is the trend to severely curtail the application of the equitable mootness doctrine. It will be interesting to see if the equitable mootness doctrine has any remaining relevance to Chapter 11 plan confirmations in the future.

## VII. INVOLUNTARY BANKRUPTCY

### A. *CREDIT UNION LIQUIDITY SERVICES, LLC v. GREEN HILLS DEV. CO. (IN THE MATTER OF GREEN HILLS DEV. CO. LLC)*

The Fifth Circuit considered the meaning of a bona fide dispute as to liability or amount for involuntary standing purposes, in the wake of the 2005 BAPCPA changes.<sup>95</sup> In particular, the bankruptcy court (although it denied the

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88. *See id.* at 328–29.

89. *See id.*

90. *See id.*

91. *See id.*

92. *See id.*

93. *Id.* at 329.

94. *See id.*

95. *See Credit Union Liquidity Serv., LLC v. Green Hills Dev. Co.*, 741 F.3d 651 (5th Cir.

involuntary petition) applied a different standard to the bona fide dispute inquiry under section 303(b) of the Code than it did under section 303(h) of the Code.<sup>96</sup>

Prior to BAPCPA, section 303(b) did not include the language: “as to liability or amount.”<sup>97</sup> Rather, the statute referenced only a bona fide dispute, which the circuit had previously limited to liability (as opposed to amount).<sup>98</sup> Previously, therefore, a “dispute as to the amount of the claim, even if as to the total amount of the claim (for example, through an offsetting counterclaim), was not considered a basis to deny standing.”<sup>99</sup> However, by adding the phrase “as to liability or amount,” Congress clearly changed this precedent and, in the wake of BAPCPA, a bona fide dispute as to the *amount* of the debt, including as to liability, defeats the petitioning creditor’s standing.<sup>100</sup>

This opinion confirms that the language of the statute, as changed by Congress, means what it says, undoubtedly making it harder to prove the elements necessary for an involuntary bankruptcy.

## VIII. JUDICIAL ESTOPPEL

### A. *AXIS SURPLUS INS. CO. V. FLUGENCE (IN THE MATTER OF FLUGENCE)*

Practitioners are familiar with the Fifth Circuit’s *en banc* opinion in *Reed v. City of Arlington*, which held that, although a debtor was judicially estopped from pursuing a prepetition cause of action for his failure to disclose the same on his schedules, the debtor’s trustee should not be judicially estopped to pursue the cause of action for the benefit of the estate.<sup>101</sup> In *Flugence*, the Circuit considered the question of whether, in such a case, the trustee was limited in the amount that he could seek to the amount of unpaid claims in the bankruptcy case.<sup>102</sup>

As is too often the case, the debtor received a discharge without informing the bankruptcy court of the existence of an affirmative cause of action<sup>103</sup> (although here it was a Chapter 13 debtor and the cause of action only arose postpetition, which is unlike most judicial estoppel cases where the cause of action exists as of the petition date and must clearly be disclosed on the schedules).<sup>104</sup> The defendant, recognizing that the trustee would not be estopped from pursuing the claim, argued that any recovery should be limited to the debts remaining outstanding.<sup>105</sup>

The circuit noted that the debtor had a continuing duty to disclose assets,

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2014).

96. *See id.* at 654.

97. *See id.* at 656.

98. *See id.*

99. *Id.* at 656–57.

100. *See id.* at 657.

101. *See Reed v. City of Arlington*, 650 F.3d 571, 573–76 (5th Cir. 2011) (*en banc*).

102. *See generally* *Axis Surplus Ins. Co. v. Flugence (In the Matter of Flugence)*, 738 F.3d 126 (5th Cir. 2013).

103. *See id.* at 128.

104. *See id.* at 129.

105. *See generally id.*

including those that arose postpetition.<sup>106</sup> While the claim arose not only postpetition but also postconfirmation, the confirmation order specified that property of the estate would vest in the debtor only upon discharge, which would be years later given the nature of Chapter 13.<sup>107</sup> Thus, the debtor had a duty to disclose the asset and, by her failure to do so, she implicitly represented that the asset did not exist.<sup>108</sup> The circuit agreed that the debtor was judicially estopped to pursue the claim.<sup>109</sup> With respect to whether the trustee was limited in pursuing the claim just for the amount of unpaid claims, however, the circuit concluded that there was no such limitation.<sup>110</sup> Although the opinion is not clear with respect to what this means, the defendant had argued that “it would be inconsistent with the goals of bankruptcy to allow the trustee to pursue a claim where, as here, it would disproportionately benefit the attorneys over the creditors.”<sup>111</sup> The court rejected this argument, noting that not being able to pay an attorney would thwart the goal of the Code to maximize assets.<sup>112</sup> Moreover, the Code provided for a mechanism to ensure that attorneys were only fairly compensated.<sup>113</sup>

Ultimately, the holding is clear: “where a debtor is judicially estopped from pursuing a claim he failed to disclose to the bankruptcy court, the trustee . . . may pursue the claim without any limitation not otherwise imposed by law.”<sup>114</sup> What is unclear is whether any of the benefit of the claim or its proceeds may flow to the judicially estopped debtor (i.e., trustee obtains sufficient proceeds to pay all claims, leaving an amount that would otherwise be distributed to the debtor). Given that the Fifth Circuit was clearly troubled (as it always has been) with a debtor benefiting from its failure to disclose, and that the discussion involved administrative claims and not any benefit to the debtor, it may well be that a trustee would be capped at a recovery amount that ensured no benefit to the debtor, although this is not the literal language of the holding. On the other hand, judicial estoppel is applied against the *plaintiff* and not against the *claim*.<sup>115</sup> While the debtor may not be a plaintiff, if someone else can be the plaintiff, the underlying claim is still the same as it otherwise is under nonbankruptcy law. If that claim entitles the plaintiff to an award of X, then that should be the award regardless of whether the plaintiff is the debtor or the trustee, unless the Code alters the elements applicable to nonbankruptcy causes of action—which it does not. Moreover, with a trustee as the plaintiff, the trustee would have a sound business reason to compromise a claim at an amount that does not provide recovery to the debtor, thereby providing any potential “punishment” to the debtor as a result of the failure to disclose.

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106. See *id.* at 129.

107. See *id.*

108. See *id.* at 130.

109. See *id.* at 128.

110. See *id.* at 132.

111. *Id.* at 131.

112. See *id.*

113. See *id.*

114. *Id.* at 132.

115. See *id.*

## IX. JURISDICTION

A. *IN THE MATTER OF FRAZIN*

The courts continue to struggle with *Stern v. Marshall*, as has been noted in prior Surveys.<sup>116</sup> In this Survey period, the primary struggle was whether parties could consent to the bankruptcy court's entry of a final judgment in a non-core proceeding. By the time that this Survey is published (or shortly thereafter), the Supreme Court will have considered this issue in *In re Bellingham Insurance Agency, Inc.*<sup>117</sup> Practitioners will almost certainly be aware of the results of the Supreme Court's review and, if they are not, they should immediately familiarize themselves with the opinion. The authors can only hope that the Supreme Court will not write section 157(c)(2) out of the Judiciary Code as the implications for bankruptcy practice are grave indeed (unless Congress is finally prepared to make bankruptcy courts Article III courts, which would save the judiciary and litigants massive uncertainty and massive attorney's fees, but is, alas, a likely pipe dream).

In the meantime, practitioners must contend with a potentially devastating opinion from the Fifth Circuit although, unless the Supreme Court avoids the issue, the Fifth Circuit's opinion will be replaced with the results in *In re Bellingham Insurance Agency, Inc.*

In *In the Matter of Frazin*, the Fifth Circuit considered a now-standard *Stern v. Marshall* issue as it affects state law counterclaims against court-approved counsel.<sup>118</sup> The Chapter 13 debtor retained counsel under the Code, and that counsel helped recover millions of dollars in recovery for the estate.<sup>119</sup> Counsel filed applications with the bankruptcy court for the approval of its fees, but the debtor objected.<sup>120</sup> However, the debtor not only objected, but also asserted state law counterclaims against the attorneys for negligence, breach of duty, and the Texas DTPA.<sup>121</sup> The bankruptcy court overruled the objection and allowed the fees as requested, denying the counterclaims in the process.<sup>122</sup>

Applying *Stern v. Marshall*, the Circuit Court concluded that the bankruptcy court had the authority to enter final judgment on the negligence and breach of duty claims, but not on the Texas DTPA claim.<sup>123</sup> This is because "resolution of the fee application proceedings necessarily resolved the malpractice counterclaim," as well as the breach of duty counterclaim, as both such counterclaims had to be resolved in order for the bankruptcy court to adjudicate

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116. See, e.g., Joseph J. Wielebinski & Davor Rukavina, *Bankruptcy*, 65 SMU L. REV. 279 (2012).

117. *Executive Benefits Insurance Agency v. Arkison (In re Bellingham Insurance Agency, Inc.)*, 702 F.3d 553, 556 (9th Cir. 2012), cert. granted, 133 S. Ct. 2880 (No. 12-1200). This opinion is important not only for the issue of consent, but also because it holds that bankruptcy courts do not have Constitutional authority to adjudicate fraudulent transfer claims.

118. *Frazin v. Haynes & Boone, LLP (In the Matter of Frazin)*, 732 F.3d 313, 316 (5th Cir. 2013).

119. See *id.* at 316-17.

120. See *id.* at 317.

121. See *id.*

122. See *id.*

123. See *id.* at 321-23.

the attorneys' entitlement to fees.<sup>124</sup> With respect to the Texas DTPA claim, however, the Circuit concluded that the bankruptcy court lacked constitutional authority to enter judgment, as the resolution of that claim was not necessary to the fee applications. However, the Circuit also concluded, rather strangely, that "all factual determinations made in the course of analyzing Frazin's DTPA claim were within the court's constitutional authority because they were necessarily resolved in the process of adjudicating the fee applications."<sup>125</sup> Presumably this would mean that, if the debtor pursues the Texas DTPA claim, the same findings of fact would apply, although this is left unresolved.

But none of the above is the true importance of *In the Matter of Frazin*, for the above is a straightforward application of *Stern v. Marshall*. Rather, what is the most important aspect of this opinion is the Circuit's discussion of consent to the entry of final judgment in a non-core proceeding.<sup>126</sup> Here, the debtor brought his counterclaims in the bankruptcy court voluntarily, and appeared to have at least implicitly consented to final judgment over non-core matters.<sup>127</sup> The attorneys argued that, as a result, the bankruptcy court had full authority to render final judgment on all causes of action.<sup>128</sup> The Circuit rejected this argument in a footnote as follows:

However, when separation of powers is implicated in a given case, the parties cannot by consent cure the constitutional difficulty. When these Article III limitations are at issue, notions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect. As discussed above, *Stern* makes clear that the practice of bankruptcy courts entering final judgments in certain state-law counterclaims compromises the integrity of the system of separated powers and the role of the Judiciary in that system. Thus, structural concerns cannot be ameliorated by Frazin's consent or waiver.<sup>129</sup>

In other words, 28 U.S.C. § 157(c)(2) is unconstitutional, although the court did not state so. No other conclusion is possible, however, if consent to final judgment does not grant authority in non-core proceedings. That the circuit would so state, in a footnote, with no real analysis, and seemingly *ipse dixit*, is troubling, to say the least.

#### B. *IN RE BP RE, L.P.*

In *In the Matter of BP RE, L.P.*, the Fifth Circuit held the same as it did in *In the Matter of Frazin*, to the effect that consent does not confer authority to enter final judgment in non-core matters.<sup>130</sup> At least in *In the Matter of BP RE, L.P.*, the Circuit so held after an analysis and citation, and not in a footnote. But the

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124. See *id.*

125. *Id.* at 324.

126. See *id.* at 320 n.3.

127. See *id.*

128. See *id.*

129. *Id.* (internal citation and quotation omitted).

130. *BP RE L.P. v. RML Waxahachie Dodge LLC (In re BP RE, L.P.)*, 735 F.3d 279, 286–87 (5th Cir. 2013).

result is surprising and shows the games that will be played without a clear directive from the Supreme Court on the lingering fallout from *Stern v. Marshall*. Here the result is that a litigant, having commenced an action in bankruptcy court and having explicitly consented to final judgment—particularly as *the debtor*—was able to escape and reverse course when things did not go its way.<sup>131</sup>

The debtor filed an adversary proceeding in the bankruptcy court asserting various state law claims against the defendants.<sup>132</sup> The bankruptcy court entered a final judgment against debtor-plaintiff, and the debtor-plaintiff appealed.<sup>133</sup> Of importance, the debtor-plaintiff filed a document with the bankruptcy court explicitly stating that the proceeding was non-core and explicitly consenting to the bankruptcy court's entry of final judgment.<sup>134</sup> After the bankruptcy court denied the plaintiff's request for a jury, the plaintiff sought to withdraw the reference and argued that it had not consented to final judgment by the bankruptcy court.<sup>135</sup> On appeal, the plaintiff argued that the bankruptcy court lacked authority to enter final judgment in light of *Stern v. Marshall*—even though the plaintiff was the debtor, even though the plaintiff filed suit in the bankruptcy court, and even though the plaintiff explicitly consented to final judgment.<sup>136</sup>

The Fifth Circuit first looked at whether the proceeding was statutorily core and whether the bankruptcy court had the statutory authority to enter final judgment, both of which questions the circuit answered in the affirmative.<sup>137</sup> Although the Circuit was certainly concerned with the plaintiff's "gamesmanship," the circuit nevertheless held that the Constitution required analysis of the bankruptcy court's power, in effect testing the constitutionality of section 157(c)(2) of the Judiciary Code.<sup>138</sup> The court adopted the reasoning of the Sixth Circuit from its *Waldman* case, and concluded that consent to final judgment in a non-core proceeding was insufficient.<sup>139</sup> As held by the Fifth Circuit:

Where a structural interest is triggered, the parties cannot by consent cure the constitutional difficulty for the same reason that the parties by consent cannot confer on federal courts subject-matter jurisdiction beyond the limitations imposed by Article III, § 2. When these Article III limitations are at issue, notions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect.<sup>140</sup>

The Circuit Court proceeded to construe and apply *Stern v. Marshall* broadly, even though it noted that the opinion was intended to address a narrow

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131. *See id.* at 285.

132. *See id.* at 281.

133. *See id.*

134. *See id.* at 282.

135. *See id.*

136. *See id.*

137. *See id.* at 285.

138. *See id.*

139. *See id.* at 286–87 (citing *Waldman v. Stone*, 698 F.3d 910, 930 (6th Cir. 2012)).

140. *Id.* at 288 (internal citation and quotation omitted).

question.<sup>141</sup> Accordingly, the Circuit concluded that the bankruptcy court lacked constitutional authority over the action notwithstanding the consent of the parties under 28 U.S.C. § 157(c)(2).<sup>142</sup> The court reiterated what it stated in *Frazin*: “separation of powers is implicated in a given case, the parties cannot by consent cure the constitutional difficulty. When these Article III limitations are at issue, notions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect.”<sup>143</sup>

The Fifth Circuit should not have engaged in a *jurisdictional* analysis. Inability to confer or consent to jurisdiction applies just to that—jurisdiction. But there should have been no question of the bankruptcy court’s jurisdiction under 28 U.S.C. § 1334, and it is that statute that is the subject matter jurisdiction statute. Authority to enter judgment is something different and, whatever it is, it should not be subject to the inability to consent issue. Unless, that is, parties should be unable to consent to a magistrate judge—something that the circuit attempts to address, again in a footnote, without much success.<sup>144</sup> Magistrates are not implicated because of the need for consent of all parties and because the district court may vacate the reference *sua sponte*.<sup>145</sup> But that is also precisely the case with respect to bankruptcy. And reading *Stern v. Marshall* as “a narrow holding not affecting magistrate judges” is strange, given that the opinion reads *Stern v. Marshall* broadly by its own admission.<sup>146</sup>

What about arbitration? Parties agree to an arbitration and, with very limited exceptions, a federal court must enter judgment on the verdict and must enforce the judgment.<sup>147</sup> Does this not offend the dignity of the federal courts? And why would bankruptcy courts endanger the “institutional interests” of Article III courts? After *Northern Pipeline*, circuit courts appoint, discipline, and remove bankruptcy judges, and district courts do not have to refer matters to bankruptcy courts. Here again the circuit appears to proclaim *ipse dixit* without much analysis. If anything, the courts should focus on agency reviews, which are *de facto* courts appointed by the executive and, while judicial review is available, it is limited. With respect to bankruptcy courts, the district court can always withdraw the reference and there are appeals.

One can understand the need to protect Article III of the Constitution and the importance of the Article III judiciary being vigilant against the encroachment of its power. Goals of efficiency and expediency are no license to violate the Constitution. In an academic setting, cases like *Stern v. Marshall*, and now *In the Matter of BP RE, L.P.* and *In the Matter of Frazin*, have intellectual appeal and probably represent exactly the kind of healthy territorial defensiveness that the Founding Fathers wanted to motivate in our three equal

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141. See *id.* at 291.

142. See *id.* at 288.

143. *Id.* at 290 (quoting *Frazin v. Haynes & Boone, LLP (In the Matters of Frazin)*, 732 F.3d 313, 320 n.3 (5th Cir. 2013)).

144. See *id.* at 288 n.11.

145. See *id.*

146. Compare *id.* at 288 n.11, with *id.* at 291.

147. See, e.g., *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1752–53 (2011).



branches of government. Those practitioners that disagree with the logic of these and similar cases, and certainly their results, perhaps arrive at their views not so much based on cold academics, or on the need for broad Constitutional principles that will govern for decades or centuries, but based on the knowledge that these opinions are making it significantly harder to administer bankruptcies. And it certainly can be of no comfort to bankruptcy judges, who work exceptionally hard and who have huge case loads, and who probably try the bulk of civil issues in the federal system, and who publish many opinions on difficult civil and commercial issues that benefit all, to hear of their Constitutional irrelevance. Or, perhaps it is precisely because bankruptcy judges are deciding so many civil and commercial cases, and issuing so many opinions on which many other courts, federal and state, rely, that curtailing their authority appears necessary. But then why do Article III district courts decide so many fewer commercial cases (or publish fewer opinions)?

This debate will not end. Everyone will continue to be frustrated by it, and the parties who will suffer the most are litigants, who must expend substantial and precious resources in arguing jurisdictional issues in almost every case of any size and who, it appears, may not have quite the finality that they believed bankruptcy brings. There is only one cure, which is to make bankruptcy judges Article III judges, albeit of limited subject matter. This will not happen any time soon, the same as it did not happen in 1978.<sup>148</sup> In light of that fact, the authors can only encourage Article III courts, and district courts in particular, to be more accommodating to the practical needs and realities of bankruptcy litigants, who may find themselves having to try matters in district court far more often than district courts are used to.<sup>149</sup>

## X. LIEN AVOIDANCE (SECTION 1146(C))

### A. ACCEPTANCE LOAN CO. v. S. WHITE TRANSPORTATION, INC. (IN RE S. WHITE TRANSPORTATION, INC.)

Section 1141(c) of the Bankruptcy Code generally provides that, “[e]xcept as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.”<sup>150</sup> On the other hand, there is the long-standing rule that a secured creditor may ignore the bankruptcy proceedings and that his lien will

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148. See *Northern Pipeline Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 60-61 (1982).

149. One idea that can be immediately implemented is to ensure that, in multi-judge divisions, the same district court judge hears all matters for which the reference is withdrawn from the same bankruptcy case and related adversary proceedings. Another is to have an expedited rule for the withdrawal of the reference because, depending on the local rules and needs of the case, this process alone could take several months, such as by the bankruptcy court promptly recommending the same without need for motion, response, reply, hearing, report and recommendation, more briefing in the district court, and then potentially significant time to decide. For example, if the parties and the bankruptcy judge certify that the matter is non-core, the reference should be automatically withdrawn the same as it is automatically issued.

150. 11 U.S.C. § 1141(c) (2012).

pass through bankruptcy unaffected.<sup>151</sup> How then do you reconcile these two conflicting principles?

The Fifth Circuit revisited the issue in *In the Matter of S. White Transportation, Inc.*<sup>152</sup> The secured creditor never filed a proof of claim or participated in the Chapter 11 case.<sup>153</sup> However, the debtor did serve the secured creditor with the debtor's plan, which provided for no recovery to the secured creditor (and noted that the debtor contested the validity of the creditor's lien).<sup>154</sup> The plan was confirmed and the debtor argued that, as a result of section 1141(c) of the Code, the property reverted free and clear of the lien and the creditor "participated" in the bankruptcy case as a result of being served with the debtor's plan.<sup>155</sup>

The Fifth Circuit disagreed with the debtor and held that the lien was not avoided.<sup>156</sup> The Court recognized the rule that four conditions must be met in order for a lien to be avoided under section 1141(c) of the Code: "(1) the plan must be confirmed; (2) the property that is subject to the lien must be dealt with by the plan; (3) the lien holder must participate in the reorganization; and (4) the plan must not preserve the lien."<sup>157</sup> The issue was the third element—did the creditor, simply by being served with the plan, "participate" in the reorganization?

The court recognized that this requirement was a judicial gloss on the statute.<sup>158</sup> Nevertheless, the Circuit noted that "that the word 'participation' connotes activity, and not mere nonfeasance."<sup>159</sup> One method of participation in the bankruptcy case is the filing of a claim.<sup>160</sup> Thus, the court concluded that "meeting the participation requirement . . . requires more than mere passive receipt of effective notice."<sup>161</sup>

This is a troubling opinion, and a potentially dangerous one. Certainly jurisdiction and due process are critical to Chapter 11, but the Fifth Circuit did not address the question under either principle. Indeed, the debtor actually served the plan on the creditor.<sup>162</sup> What the court failed to address was finality—a critical issue in Chapter 11.<sup>163</sup> The debtor and all parties, including new lenders or new capital funders, must have finality and certainty in knowing what the debtor's obligations and liens postconfirmation are. The Circuit Court also seems to have failed to apply its own precedent, to the effect that the courts should not rewrite or add to a clear statute.<sup>164</sup> The Circuit seems to have ignored section 1141(a) of the Code, providing for the binding effect of a plan. And

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151. See, e.g., *Simmons v. Savell (In re Simmons)*, 765 F.2d 547, 556 (5th Cir. 1985).

152. *Acceptance Loan Co. v. S. White Transp. (In re S. White Transportation, Inc.)*, 725 F.3d 494, 495 (5th Cir. 2013).

153. See *id.* at 495.

154. See *id.* at 495–96.

155. See *id.* at 496.

156. See *id.* at 498.

157. *Id.* at 496.

158. See *id.* at 497.

159. *Id.*

160. See *id.*

161. *Id.* at 498.

162. See *id.* at 496–97.

163. See generally *id.*

164. See, e.g., *King Ranch, Inc. v. United States*, 946 F.2d 35, 37 (5th Cir. 1998).

what about discharge: if a creditor does not file a proof of claim but is served with a plan, will the creditor's claim no longer be discharged? After all, what is the difference between lien avoidance under section 1141(c) and one of a whole number of other things that happen upon plan confirmation and effectiveness *vis a vis* a party that has not "participated" in the case, other than the pronouncement that a secured creditor may pass his lien through bankruptcy? And, how can that judicial pronouncement trump the explicit provisions of the Code, provided of course that due process is complied with?

But most troubling of all is the lack of any meaningful discussion or consideration of what constitutes "participation," other than the simple filing of a proof of claim, which is a circular argument (since the whole issue arises precisely because the creditor has not filed a claim). Can the debtor file an adversary proceeding against the creditor pre-confirmation to force "participation?" Perhaps, but then the creditor "participates" in the adversary proceeding. Can the debtor file a zero amount proof of claim for the creditor? Sure, but how would that not be the same kind of passive participation by the creditor as is the case with a plan. Can the debtor file a claim for the creditor and object to the claim, including on the basis of an invalid lien? But what if the lien is valid and the only basis for avoidance is section 1141(c)?

It may be that *In the Matter of S. White Transportation, Inc.* will not be as important or dangerous as feared, once the practitioner is aware that service of the plan by itself will not lead to lien avoidance for a non-participating secured creditor (which is perhaps a wake up call to Chapter 11 practitioners, many of whom probably believed that section 1146(c) meant exactly what it says). But it will be up to careful and potentially creative practitioners and courts to provide meaningful guidance and examples of what "participation" without a filed claim means. The Fifth Circuit, unfortunately, has provided none.

As is, without some coerced "participation," it may be that a secured creditor can effectively veto a Chapter 11 plan that depends on the treatment of the creditor's lien by simply not filing a claim. And, if the current jurisdictional discussion continues to proceed in the direction that it has, then does the bankruptcy court even have any jurisdiction over the creditor or its lien if the creditor does not consent to bankruptcy jurisdiction by filing a claim? The day will come when a major secured creditor, who does not wish to be crammed down, will simply not file a claim. Someone will try to file a claim for the creditor, and the creditor will argue that the bankruptcy court will not have jurisdiction, or certainly not core jurisdiction, not only over lien avoidance but any lien modification at all, because the creditor has not subjected himself voluntarily to such jurisdiction. In light of *Stern* and Fifth Circuit precedent on non-core matters, what will the counterargument be? Or will the matter have to proceed in district court? Section 1146(c) is the most important inducement to bring secured creditors into the bankruptcy process, since they would certainly much rather face the prospect of negotiations, a plan, and maybe a cramdown, than the loss of their lien outright. But if that carrot and stick is gutted—as the Fifth Circuit appears to have done—then why would a secured creditor participate in Chapter 11 at all?

## XI. SALES

A. *NEWCO ENERGY V. ENERGYTEC INC. (IN RE ENERGYTEC INC.)*

Practitioners know, and rely upon the fact that, most bankruptcy section 363 sales are protected from reversal on appeal, which is a major benefit of bankruptcy sales and one of the reasons why bankruptcies are filed (in order than fair value may be obtained for an asset which was otherwise subject to competing claims outside of bankruptcy). The Fifth Circuit addressed the appeal mootness issue in *In re Energytec Inc.*, in an opinion that may threaten this bedrock policy and tool of the Code.<sup>165</sup>

The debtor sold its pipeline during the bankruptcy case, and the bankruptcy court reserved the issue of whether the sale was free and clear of the appellant's fees and interests in the pipeline (apparently because the sale could not be free and clear of covenants running with the land).<sup>166</sup> The ultimate underlying issue concerned whether the appellant's rights were covenants running with the land, which the bankruptcy court, approximately one year after the sale, ruled they were not.<sup>167</sup> The appellant did not obtain a stay pending appeal.<sup>168</sup> The debtor argued that the appeal was moot under section 363(m) of the Code.<sup>169</sup> The circuit eventually reversed the lower court's conclusion on whether the appellant's rights were covenants running with the land, thereby raising the issue at relief, if any, the circuit could grant with respect to the sale.<sup>170</sup>

The circuit recounted the strong policies behind section 363(m) and the paramount goal of finality in bankruptcy sales.<sup>171</sup> However, the Circuit noted that the appellant was not challenging the sale *per se*, but rather only the aspect of the sale concerning whether the sale was free and clear of the appellant's rights.<sup>172</sup> Crucially, the bankruptcy court carved this issue out of the sale order for adjudication at a future date, and only one year later did the bankruptcy court adjudicate the issue.<sup>173</sup> Apparently, the buyer decided to proceed in the face of the potential legal and financial risks involved concerning the appellant's claims.<sup>174</sup>

As held by the court, section 363(m) applies "when the challenged provision is 'integral to the sale' of the debtor's assets, which occurs 'if the provision is so closely linked to the agreement governing the sale that modifying or reversing the provision would adversely alter the parties' bargained-for exchange.'"<sup>175</sup> While this applies to sales, it can also apply to an aspect of a sale concerning the

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165. *Newco Energy v. Energytec Inc. (In re Energytec Inc.)*, 739 F.3d 215 (5th Cir. 2013).

166. *See id.* at 217.

167. *See id.*

168. *See id.* at 218.

169. *See id.*

170. *See id.* at 226.

171. *See id.* at 218-19.

172. *See id.* at 219.

173. *See id.*

174. *See id.*

175. *Id.* at 220 (quoting *In re Trism, Inc.*, 328 F.3d 1003, 1007 (8th Cir. 2003)).

free and clear provision of section 363(f) of the Code.<sup>176</sup> Thus, section 363(m) of the Code may apply to a free and clear aspect of a sale order if “the purchaser would not have consummated the sale without assurance that it was acquiring control of the debtor’s business, and the provisions for lien release, claims satisfaction, and distribution were essential to acquisition of control.”<sup>177</sup> Here, the buyer agreed to buy the pipeline notwithstanding the carve out from section 363(f) of the appellant’s rights.<sup>178</sup> Thus, the buyer demonstrated through its actions that it would have closed the sale even without the free and clear protection.<sup>179</sup> Equally as important (and hence why the opinion may be limited to its facts) is the fact that the appellant could not have moved for a stay pending appeal at the time of the sale order, thereby potentially avoiding section 363(m) of the Code, because the bankruptcy court had not adjudicated its rights until more than one year later.<sup>180</sup> It would be unfair and unworkable (and potentially more prejudicial to the bankruptcy estate) for the appellant to move for a stay pending appeal at a time when it was not known whether the buyer’s rights would even be implicated and whether the buyer would even need to move for a stay pending appeal.

The result, while probably technically correct, and while recognizing that section 363(m) applies not only to the sale itself but also to any free and clear provision integral to the sale, nevertheless limits the application of section 363(m) of the Code. Given that this is one of the most important tools that is used to increase value to an estate, any limitation on the section should be as narrow as possible. The problem in this case was that the buyer agreed to the sale notwithstanding the potential that it might not be free and clear of the appellant’s rights, and that the bankruptcy court took one year to resolve those rights, by which time the eggs had been scrambled. Had the buyer not so agreed, the result may well have been different. But then, there may well have been no sale, or a sale would have been for greater consideration. That is the problem. On the one hand, the estate needs to monetize the asset for as much as possible, and sometimes as quickly as possible. On the other hand, the due process rights of a claimant must be honored. Usually this is accomplished by attaching the claim to the proceeds of the sale. This case, however, demonstrates the difficulties that may be involved when the claimant’s right is not the type of interest in property that can be easily sold free and clear, and which does not therefore attach to the proceeds. Parties to such a sale must be aware of these potential issues as soon as possible, either to procedurally and substantively position themselves for section 363(m) protection, or to put in place alternate protection that will still enable the sale to proceed, while protection potential in rem claimants, such as escrow accounts.

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176. *Id.*

177. *Id.*

178. *See id.*

179. *See id.*

180. *See id.*

## XII. TAXES

A. *HALL V. UNITED STATES*

Most practitioners assume that postpetition taxes automatically become taxes against the estate payable as administrative claims under section 503(b) of the Code. The Supreme Court visited the issue and the intersection of the Bankruptcy Code and the Internal Revenue Code in *Hall v. United States*.<sup>181</sup>

This was a Chapter 12 case.<sup>182</sup> During the case, the debtor sold his farm, which triggered a capital gains tax.<sup>183</sup> The precise question was the treatment of this tax under the debtor's Chapter 12 plan, but more generally the question was whether the tax, being incurred postpetition, was a tax "incurred by the estate."<sup>184</sup> Reviewing sections 1222, 503, and 507 of the Code, the Court noted that the tax is a liability of the estate, as opposed to the debtor, only if "incurred" by the estate.<sup>185</sup> In other words, section 503(b) does not accord immediate administrative claim status for any postpetition taxes that may be assessed against a debtor; just those actually incurred by the estate itself as a legal entity.<sup>186</sup> In this respect, and reviewing the Internal Revenue Code, the Court held that the estate in Chapter 12 is not a legal entity subject to being taxed.<sup>187</sup> Because the estate itself in Chapter 12 is not subject to being taxed under non-bankruptcy law, there is no tax "incurred" by the estate and the Code does not change this result.<sup>188</sup>

This is an interesting opinion, and perhaps surprising to some, given the assumption that postpetition taxes are automatically administrative claims. However, the opinion is likely limited to Chapter 12 and Chapter 13 cases. There is one potential consequence that may be of relevance to Chapter 11. Under the Internal Revenue Code, and as held by *Hall*, an estate is ordinarily not a taxable entity.<sup>189</sup> The exception is Chapter 7 and Chapter 11 "in which the debtor is an individual."<sup>190</sup> It therefore seems that, if the Chapter 11 debtor is a corporation, there may be no taxable entity and no postpetition taxes against the estate. Of course, in order to confirm a plan, taxes against both the estate and the debtor must be addressed, so at the Chapter 11 plan stage it may be irrelevant whether the estate is a taxable entity or not. The more interesting question is what happens in the event of a conversion or dismissal?

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181. *Hall v. United States*, 132 S. Ct. 1882 (2012).

182. *See id.*

183. *See id.* at 1885–86.

184. *Id.*

185. *See id.*

186. *See id.*

187. *See id.* at 1887.

188. *See id.* at 1887–88.

189. *See* 26 U.S.C. § 1399; *Hall*, 132 S. Ct. at 1387.

190. 26 U.S.C. § 1398(a).