Volume 65 | Issue 2 Article 6

January 2012

Bankruptcy

Joseph J. Wielebinkski

Davor Rukavina

BANKRUPTCY

*Joseph J. Wielebinski**
*Davor Rukavina***

TABLE OF CONTENTS

* Shareholder, Munsch Hardt Kopf & Harr, P.C, Dallas, Texas; B.A. Temple Univ.; M.P.A., Maxwell School of Syracuse University; J.D., Syracuse Univ. College of Law.
** Shareholder, Munsch Hardt Kopf & Harr, P.C, Dallas, Texas; B.A., Whitman College; J.D., Texas Tech University School of Law.

I. INTRODUCTION

THE year 2011 was an interesting one for bankruptcy practitioners indeed. Aside from the large number of real estate bankruptcy cases, and the continuing increase in personal bankruptcies, many Texas practitioners wondered why they had not seen the large Chapter 11 cases they expected from the continuing financial problems (some of which did file for bankruptcy, albeit in New York or Delaware). Those law firms that "ramped up" for more large Chapter 11 filings found themselves without much work. Economically, therefore, the year has been somewhat challenging for many Texas bankruptcy practitioners.

At the higher levels, the law has been just as turbulent as the practice. In effect, 2011 is the opposite in many ways of 2010. Here is what the authors wrote last year: "As [the Fifth Circuit] clamped down on the effects of Chapter 11 plans (for example, its judicial estoppel opinions), the Fifth Circuit and other courts continued to recognize the broad scope of bankruptcy jurisdiction . . . ."[1] The opposite can be said of 2011: the Fifth Circuit issued multiple "bankruptcy friendly" opinions, while the Supreme Court delivered a bombshell sure to occupy courts and practitioners for years to come as they cope with the narrow holding of that case and with its broader implications.

Specifically, the Supreme Court, in *Stern v. Marshall*,[2] revisited the ghost of *Northern Pipeline*[3] and explored the extent of bankruptcy jurisdiction, delivering an arguably devastating result that has left courts and practitioners struggling with important questions of subject matter jurisdiction. No doubt future Texas Surveys will focus heavily on these developments. At the same time, the Fifth Circuit delivered a triumvirate of opinions that most practitioners have applauded as a retreat from several of the harsh opinions that the Fifth Circuit delivered in recent years, which opinions have been discussed in prior Surveys and criticized by many commentators. Thus, the Fifth Circuit has backed away from the *United Operating* rule, it reversed *en banc* the inequitable result in *Reed v. City of Arlington*,[4] and it acted *sua sponte* to prevent a potentially similar end to its *Scopac* equitable mootness holding. While reasonable minds can differ, those who have been confused and worried about the Fifth Circuit's bankruptcy opinions from recent years can rejoice.

1. Joseph J. Wielebinski & Davor Rukavina, *Bankruptcy*, 64 SMU L. Rev. 49, 50 (2011).
2. Stern v. Marshall, 1131 S. Ct. 2594 (2011).
3. N. Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982).
4. Reed v. City of Arlington, 650 F.3d 571 (5th Cir. 2011).

What follows below is a discussion of some of the more significant opinions from 2011 from the Supreme Court, the Fifth Circuit, and courts in the Fifth Circuit. While the number of opinions discussed is not as large as in prior Surveys, their direct legal import and the trends they appear to herald is of long-term importance to the practitioner.

II. CHAPTER 11 PLANS

A. CLAIM RETENTION: *IN RE* TEXAS WYOMING DRILLING, INC.[5]

In re Texas Wyoming Drilling, Inc. is an important Fifth Circuit opinion dealing with claims preservation in a Chapter 11 plan and follows up on the Fifth Circuit's previous important *United Operating* precedent. Additionally, *Texas Wyoming* addresses an apparent matter of first impression in the circuit concerning the role of the disclosure statement in the claims preservation analysis.

In *United Operating*, the Fifth Circuit held that a reorganized debtor lacked standing to prosecute preconfirmation causes of action postconfirmation because the debtor failed to properly preserve the causes of action in its plan.[6] In that case, the plan contained a categorical reservation of claims; purporting to reserve claims without describing what they were and without listing the potential defendants. While the circuit held that the plan could have preserved the claims for postconfirmation prosecution, it could do so only if the plan expressly retained the claims through "'specific and unequivocal'" language.[7] Readers of this Survey are aware of the problems that this opinion generated, and of various lower court opinions addressing these problems. Chief Judge Barbara Houser's opinion in *In re Manchester, Inc.*, for example, discussed these problems at length, at least insofar as *United Operating* applied to non-avoidance actions, and ultimately concluded that avoidance actions (as distinguished from non-bankruptcy claims) could be categorically retained in a plan.[8]

Texas Wyoming addressed this particular issue. In *Texas Wyoming*, the bankruptcy court confirmed a Chapter 11 plan purporting to retain avoidance actions, among other types of claims. Postconfirmation, the court converted the case and the Chapter 7 trustee was appointed. The trustee inherited the various preference and fraudulent transfer adversary proceedings filed by the reorganized debtor.[9] A series of fraudulent transfer defendants moved to dismiss for standing, *res judicata*, and collateral estoppel reasons, all stemming from their underlying argument that the

5. Spicer v. Laguna Madre Oil & Gas II, LLC (*In re* Tex. Wyo. Drilling, Inc.), 647 F.3d 547 (5th Cir. 2011).
6. Dynasty Oil & Gas, LLC v. Citizens Bank (*In re* United Operating, LLC), 540 F.3d 351, 356 (5th Cir. 2008).
7. *Id.* at 355 (quoting Harstad v. First American Bank, 39 F.3d 898, 902 (8th Cir. 1994)).
8. Moglia v. Keith (*In re* Manchester, Inc.), 2009 WL 2243592 (Bankr. N.D. Tex. 2009).
9. *Texas Wyoming*, 647 F.3d at 549.

plan failed to sufficiently retain the causes of action with the requisite "specific and unequivocal" language. The bankruptcy court, Judge D. Michael Lynn, denied the requested dismissal (the court also considered whether the postconfirmation conversion of the case revested the trustee with the causes of action, holding that it did, although that aspect of the opinion is not discussed herein, having been discussed in a previous Survey). The bankruptcy court then certified the appeal directly to the Fifth Circuit, and the Fifth Circuit granted the certification.

The circuit confirmed that "'after confirmation of a plan, the ability of the debtor to enforce a claim once held by the estate is limited to that which has been retained in the bankruptcy plan.'"[10] Quoting its important 2008 *United Operating* opinion, the circuit reaffirmed that, for a debtor to reserve a claim for postconfirmation prosecution, the plan must expressly retain the right to pursue the claim postconfirmation and that such reservation "'must be specific and unequivocal.'"[11] The circuit noted that the fundamental purpose of the rule was to place those voting on the plan on notice of what the plan and postconfirmation intentions were, so that they could make an informed decision on the plan.

The circuit began by considering the argument that one may look to the disclosure statement alongside the plan in considering whether the plan sufficiently retains causes of action for postconfirmation prosecution. The appellant argued that this should be impermissible, because it is the plan that is the operative document and because all of the circuit's prior precedent addressed the sufficiency of retention language in the *plan*. The circuit noted that "no court of appeals has addressed whether the disclosure statement may be consulted for purposes of standing," since *United Operating* phrased the inquiry as one of standing to prosecute the claim postconfirmation, the circuit rejected the appellant's arguments.[12] The circuit reasoned and held as follows:

> We observe that the disclosure statement is the primary notice mechanism informing a creditor's vote for or against a plan. Considering the disclosure statement to determine whether a post-confirmation debtor has standing is consistent with the purpose of *In re United Operating*'s requirement: placing creditors on notice of the claims the post-confirmation debtor intends to pursue. In light of the role served by the disclosure statement, the purpose behind the rule in *In re United Operating*, and the fact that, in similar contexts, courts routinely consider the disclosure statement to determine whether a claim is preserved, we hold that courts may consult the disclosure statement in addition to the plan to determine whether a post-confirmation debtor has standing.[13]

10. *Id.* at 550 (quoting Dynasty Oil & Gas, LLC v. Citizens Bank (*In re* United Operating, LLC), 540 F.3d 351, 355 (5th Cir. 2008)) (brackets omitted).
11. *Id.* (quoting *In re* United Operating, 540 F.3d at 355).
12. *Id.*
13. *Id.* at 551 (citations omitted).

The circuit next noted that the plan specifically provided that the reorganized debtor could bring "estate actions" postconfirmation. The plan specifically defined "estate actions" as including those arising under Chapter 5 of the Bankruptcy Code. The disclosure statement expanded on these definitions, by advising creditors that claims that the debtor could bring postconfirmation included those that can be pursued under Chapter 5 of the Bankruptcy Code. The disclosure statement also included a chart, outlining the claims that could be prosecuted postconfirmation. That chart, while not naming individual defendants for the most part, listed as potential defendants "'[v]arious pre-petition shareholders of the [d]ebtor who might be sued for 'fraudulent transfer and recovery of dividends paid to shareholders'"—exactly the claims at issue in *Texas Wyoming*.[14] Indeed, the disclosure statement even valued these causes of action, noting that they may be worth up to $4 million, which was the amount of prepetition dividends paid by the debtor. The only things missing were the names of the individual shareholders.

The circuit concluded that the plan was sufficient under *United Operating*. Noting that *United Operating* contained only a blanket reservation of "any and all claims," here the plan *and* the disclosure statement revealed the existence of the avoidance actions, the legal basis for them (Chapter 5), the identity of the defendants by category, and the potential value of the claims. As concluded by the circuit, "[t]he terms of TWD's plan and disclosure statement are far more specific than those in *In re United Operating*."[15]

Of importance, the circuit was careful to avoid any conclusion that avoidance actions could be retained by a categorical "any and all avoidance actions" language. Rather, the circuit narrowed its holding and refused to disturb *United Operating*. Nevertheless, a fair reading of *Texas Wyoming* should conclude that avoidance actions, as opposed to nonbankruptcy claims, may be reserved by category, meaning that no discrete identification of the defendants is necessary and only a short description of the legal and/or factual basis of the claims, by a whole class of defendants, is necessary. This can be distinguished from those opinions that require, for each defendant, the naming of the defendant, a statement that litigation will be brought, a factual explanation of the claim, and the naming of the legal cause of action involved. Regardless of what one may ultimately say regarding *Texas Wyoming*, there can be no question that the strict bar of *United Operating* has been relaxed significantly, at least for avoidance actions. The same cannot, however, be said of non-avoidance actions.

Moreover, the fact that *Texas Wyoming* permits reviewing the disclosure statement together with the plan is likely to have other ramifications as well, most notably to the *res judicata* and judicial estoppel arguments (*i.e.*, how can one "lay behind the law" for purposes of judicial estoppel

14. *Id.* at 549.
15. *Id.* at 551.

when the disclosure statement adequately discloses the issue?). Additionally, as can be expected given ordinary rules of contractual interpretation, the *Texas Wyoming* opinion should support a rule permitting review of the disclosure statement to address any ambiguity that might exist in the plan regarding class treatment or other matters.

Texas Wyoming is therefore an important opinion: avoidance actions, at least, can be reserved categorically in a Chapter 11 plan without need to specifically name each individual defendant and the exact cause of action against the defendant, and the disclosure statement provides potentially significant guidance in reviewing, construing, and applying the plan.[16]

B. CLAIM RETENTION: *IN RE* MPF HOLDING U.S., LLC[17]

Judge Jeffrey Bohm's decision in *In re MPF Holding* is potentially significant because it represents the extreme end of the spectrum for claims retention under a Chapter 11 plan, taking *United Operating* and imposing an even stricter standard. While the case is on appeal to the Fifth Circuit and appears to have already been indirectly overruled by the *Texas Wyoming* opinion discussed above, the case is of value to defendants being sued postconfirmation and may, depending on what happens on appeal, have persuasive effect going forward.

In *MPF Holding*, the court phrased the question as "[h]ow much detail must a plan contain to enable a post-confirmation trustee (or reorganized debtor) to prosecute claims against third-parties that arose prior to confirmation?"[18] Postconfirmation, the liquidating trustee initiated litigation against multiple parties, some of whom moved to dismiss for a failure to adequately preserve the claims under the plan. The court focused on the Fifth Circuit's requirement that the plan contain "specific and unequivocal" retention language, analyzing what this requirement means and what it actually requires. The court specifically reviewed Judge Lynn's bankruptcy court opinion in *Texas Wyoming* (the direct appeal to the Fifth Circuit had not yet been adjudicated), and disagreed with the view in that opinion and others that a defendant of an avoidance action need not be specifically named in the plan (partly for this reason, it appears that the Fifth Circuit's *Texas Wyoming* opinion, affirming Judge Lynn, indirectly overrules Judge Bohm's opinion).[19]

Ultimately, after an extensive analysis, including a review of differing opinions and options, Judge Bohm concluded as follows:

> This Court concludes that the Fifth Circuit requires that the parties to be sued after confirmation must be individually identified in the plan, and that failure to do so necessarily means that the bright-line test is not satisfied. Moreover, under the bright-line test, this Court

16. *Id.* at 551–52.
17. *In re* MPF Holdings U.S., LLC, 443 B.R. 736 (Bankr. S.D. Tex. 2011).
18. *Id.* at 740.
19. *Id.* at 744–45.

> concludes that even if the putative defendants are individually named in the plan, the provision preserving the right to sue these defendants must expressly state two other points. First, the reservation provision must set forth the legal basis for the suit—for example, § 547. Second, it must also state that following confirmation, these defendants will be sued—not that that they may be sued or could be sued or might be sued.[20]

Therefore, under *In re MPF Holding*, the plan must name the defendant, state the legal basis for the claim, and state unequivocally that the defendant will be sued. There is no question that this is an extreme view. In fact, it has already been criticized and rejected by at least two courts, and has been discussed at length (usually with a negative connotation) at various professional and bar functions.[21] But the opinion is not without logic and, depending on one's political or judicial view of the underlying question, it is not without appeal, even though it would make the liquidation of valuable estate property postconfirmation much more difficult, and would require more money to be expended, together with necessary delays, prior to the confirmation of a plan that depended on the preservation of valuable claims. Ultimately, because the claim retention dispute is not likely to die down any time soon, at least not without decisive authority from the Supreme Court, *In re MPF Holding* will provide ammunition to postconfirmation defendants even if the Fifth Circuit rejects its holding.

C. Claim Retention: *In re* Crescent Resources, LLC[22]

The authors mention *Crescent Resources* only to show the continuing development of, and disagreement concerning, the issue of claims retention under a Chapter 11 plan. This opinion, from Judge Gargotta, rejects Judge Bohm's opinion in *MPF Holding* and agrees with Judge Lynn's opinion in *Texas Wyoming*.[23] Now that the Fifth Circuit has affirmed *Texas Wyoming*, it appears that opinion will control. Nevertheless, it is interesting, and it may be important in a given case, to see how the lower courts have handled the *United Operating* opinion. Ultimately, Judge Gargotta agreed that the test is "to make a determination 'whether the language in the plan was sufficient to put creditors on notice that the debtor anticipated pursuing the claims after confirmation.'"[24] The issue was somewhat complicated by the fact that the litigation at issue was a turnover action under section 542 of the Bankruptcy Code. The plan retained various assets, including "those Causes of Action arising under Chapter 5 of the Bankruptcy Code including those actions which could be

20. *Id.* at 744–45.

21. *See In re* Crescent Res. LLC, 455 B.R. 115 (Bankr. W.D. Tex. 2011); *In re* Kimball Hill Inc., 449 B.R. 767 (Bankr. N.D. Ill. 2011).

22. *In re* Crescent Resources, LLC, 455 B.R. 115 (Bankr. W.D. Tex. 2011).

23. *Id.* at 128–29.

24. *Id.* at 129 (quoting *Texas Wyoming*, 422 B.R. at 627–28) (brackets omitted).

brought by the Debtors under Sections 544, 547, 548, 549, 550, and 551."[25] Of interest, section 542 was not specifically mentioned, although other sections under Chapter 5 of the Bankruptcy Code were identified. The question, therefore, became whether the reference to "Chapter 5" was sufficient to preserve a turnover action.

Ultimately, the court concluded that it was "far-fetched to believe that a creditor would not be on notice that the Trust anticipated pursuing turnover claims after confirmation."[26] Although section 542 itself was not specifically mentioned, the reference to Chapter 5 (of which Section 542 is a part), and the clear notice that postconfirmation litigation would be commenced, the court felt that plan language "was sufficient to put creditors voting on the Plan on notice that 542 turnover claims may be pursued."[27] In that respect, *Crescent Resources* goes farther than *Texas Wyoming* does in permitting generic language to preserve the claim, since in *Texas Wyoming* the actual Code sections being sued under were specifically named. Yet, since the underlying issue is whether creditors were put on reasonable notice as to what they were voting on, the opinion appears entirely consistent with *Texas Wyoming* and the logical underpinning of *United Operating*.

D. Separate Classification: Save Our Springs (S.O.S.) Alliance, Inc.[28]

With the large, recent increase in real estate bankruptcy cases, many of which do not involve a large or divergent group of creditors, the issue of proper classification has again come to the forefront of confirmation battles. In fact, in many real estate cases, one of the most difficult aspects of plan formulation and confirmation is classification, since the lender or lenders will likely have a large deficiency claim which will swamp the class of general unsecured creditors.

The Fifth Circuit's opinion in *Save Our Springs (S.O.S.) Alliance, Inc.* is not revolutionary or particularly novel. But it is important since it recognizes and reaffirms prior exceptions to the strict *Greystone* gerrymandering rule—exceptions, or rather ways of avoiding gerrymandering, that are more important in today's reorganization and financial environment. Although the opinion deals with several aspects of Chapter 11 confirmation, the authors discuss it with particular reference to its analysis of separate classification of similar claims.

In particular, the circuit held that a "non-creditor interest can justify separate classification."[29] Although lower courts had recognized this exception, and the Fifth Circuit had previously recognized the exception in Chapter 13 cases and suggested that the exception may apply in Chapter

25. *Id.*
26. *Id.* at 129–30.
27. *Id.* at 130.
28. *In re* Save Our Springs (S.O.S.) Alliance, Inc., 632 F.3d 168 (5th Cir. 2011).
29. *Id.* at 174.

11 cases, *Save Our Springs* provides significant authority recognizing this important exception. Expanding on what a non-creditor interest may be, the circuit held that such an interest is one that gives the rejecting creditor "'a different stake in the future viability' of [the debtor] that may cause it to vote for reasons other than its economic interest in the claim."[30] Importantly, this question is a question of fact, which also means that the bankruptcy court will have some discretion in adjudicating the argument.[31] At the same time, the exception is subject to the gerrymandering requirements of *Greystone*, and if the separate classification is not sufficiently demonstrated through appropriate evidence, the plan proponent may well run into the gerrymandering conclusion.

The circuit did not give discrete examples of what may justify a non-creditor interest. Certainly, a desire to obtain a litigation advantage in related litigation, competition with the debtor, or animosity may rise to the level of a non-creditor interest. But, it must also be demonstrated that the negative vote was the result of these or other non-creditor interests. This would be hard to do if the plan does not contain reasonable economic advantages since, even if a non-creditor interest may be present, a bad plan is alone enough to justify a negative vote from a creditor's perspective. Conversely, if the plan provides favorable economic treatment and the creditor nevertheless rejects the plan, demonstrating the need for separate classification based on the rejecting creditor's non-economic interest becomes more feasible.

E. Artificial Impairment: *In re* Village at Camp Bowie I, L.P.[32]

The Chapter 11 practitioner is well aware of the importance of classification to confirming a Chapter 11 plan on cramdown, which is all the more important given the recent number of single asset real estate cases. Closely linked to this issue is the question of impairment, since the class voting for the plan must be impaired in order for its vote to count for cramdown purposes. In cases where there are only a few relatively small creditors who can arguably be paid in full under a plan, how does the debtor properly impair those creditors so as to make their vote count? The issue led to the answer on the form of the doctrine of artificial impairment, where the plan proponent impairs a class which could otherwise readily be left unimpaired for the purpose of obtaining the necessary consent of an impaired, consenting class.

Judge D. Michael Lynn addressed this issue head on in *Village at Camp Bowie*, ultimately concluding that, under the facts of that case, it was not impermissible for the debtor to artificially impair a class of creditors even though the purpose of the impairment was to satisfy the requirement of

30. *Id.* (quoting Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co. (*In re* U.S. Truck Co.), 800 F.2d 581, 587 (6th Cir. 1986)).
31. *See id.*
32. *In re* Village at Camp Bowie I, L.P., 454 B.R. 702 (Bankr. N.D. Tex. 2011).

an impaired consenting class for cramdown purposes.[33] Of interest, the debtor in *Village at Camp Bowie* did not dispute that it had artificially impaired a class; rather, the debtor addressed the argument without subterfuge. The crux of Judge Lynn's holding was that artificial impairment was not *per se* its own doctrine, since there is no Bankruptcy Code provision on point: "It seems clear that, in the usual case, artificial impairment does not amount *per se* to a failure of good faith. Rather, it is one factor that the court may consider in its analysis under Code § 1129(a)(3)."[34] Since artificial impairment is just one factor that goes into the good faith analysis, it alone is not dispositive and can be overridden by other factors.

Village at Camp Bowie was a single asset real estate case, and Judge Lynn recognized that, in such a case, "a lender could use its overwhelming share of the claims in a case to divest other creditors and equity owners of their economic interests."[35] The lender argued that the purpose of the plan was to preserve equity. Judge Lynn had no doubt that this was true, but he noted that equity was in the money and that "Congress clearly contemplated in the Code protecting equity interests as well as those of creditors."[36] Thus, "[g]iven Congress's obvious concern for fair treatment of equity owners, the court cannot fault Debtor's concern for its equity owners."[37] And, if artificial impairment was the only way to propose a confirmable plan given the lender's overwhelming control over the plan process, Judge Lynn concluded that resort to artificial impairment was not bad faith:

> In the case at bar, Western will receive under the Plan the full value of its claim. That Debtor can only accomplish its restructuring—including preservation of equity interests—through minimal impairment of class 2 does not mean its motive in pursuing chapter 11 relief is tainted, as might be true if the case were initiated solely to gain the benefit of the automatic stay or to strip down debt.[38]

Adding to the equities of the case, and perhaps the ultimate decision, the lender purchased its claim at a discount and hoped to acquire the underlying collateral for less than its fair value, at least according to Judge Lynn. Thus, not only did Judge Lynn find that artificial impairment was not *per se* impermissible, but also concluded that it was the lender who was acting inequitably with respect to the plan process by rejecting payment in full and instead using the process to attempt to obtain the assets at less than fair value.[39]

As of this writing, it appears that *Village at Camp Bowie* will be certified for direct appeal to the Fifth Circuit. No doubt, it will be discussed in next year's Survey. While Judge Lynn's logic and ultimate holding that

33. *Id.* at 708.
34. *Id.* at 709.
35. *Id.*
36. *Id.*
37. *Id.*
38. *Id.* at 710.
39. *Id.* at 711.

artificial impairment is just one factor in the good faith analysis appears correct, and is backed up by sound logic and reason, it remains to be seen whether the Fifth Circuit will apply a *Greystone*-type analysis to the effect that one may not gerrymander impairment the same as one may not gerrymander classification, unless the appeal becomes equitably moot in the process.

F. Cramdown Interest Rate: *In re* Texas Grand Prairie Hotel Realty, LLC[40]

The Chapter 11 practitioner is well aware of the difficulties concerning the judicial calculation of a Chapter 11 cramdown rate of interest. The precedent, such as the Supreme Court's opinion in *Till*, is not directly on point and much of it is flexible and, frankly, dated. No bright line rule applies in the Fifth Circuit, and what the bankruptcy court will ultimately decide is frequently subject to uncertainty, which is made all the more complicated by the fact that the entire success or failure of the plan will frequently come down to this one issue, whose ultimate resolution cannot be known until the very end.

In re Texas Grand Prairie Hotel Realty, LLC is an imperfect opinion, but only because Judge McBryde of the district court, in affirming the bankruptcy court's decision to approve a 5% cramdown rate of interest for a portfolio of four Hyatt Place hotels,[41] does not engage in an exhaustive legal analysis. Rather, he rests on appellate review of findings of fact, together with the deference that such a review entails. More than anything, perhaps, that is the point: that the question is one of fact and that, so long as the bankruptcy court applies the correct legal standards and the record is sufficiently developed, the bankruptcy court's determination will not be disturbed on appeal.

The opinion is important for one other reason, although the reason does not directly appear in the opinion itself. Namely, the secured lender, a CMBS structure represented by the special services Berkadia, urged the bankruptcy court to adopt the so called market approach to setting the interest rate. This approach, favored by lenders and having received some success in other cases, looks to what rate the market would set for the cramdown loan. Because no lender would extend a loan with a 1-to-1 loan to value ratio, the approach usually breaks the loan down into tranches of debt, and looks at how a first priority lender, mezzanine lender, and typically an equity contributor would price their particular levels of risk. The approach then blends the two or three separate interest rates (for example, 6%, 11%, and 20%) into one overall rate, which is usually much higher than the plan proposes and which is usually large enough to render the plan not feasible. The bankruptcy court rejected this approach, and instead applied a case-by-case, factual approach.

---

40. *In re* Texas Grand Prairie Hotel Realty, LLC, Bankr. No. 10-432-42-rfn11, 2011 WL 5429087 (N.D. Tex. 2011).
41. *Id.* at *6.

The lender urged Judge McBryde to conclude, as a matter of law, that the bankruptcy court erred by not adopting the market approach. In other words, the lender urged the court to adopt an inflexible, bright-line rule as a matter of law. Judge McBryde rejected this approach, which, as noted above, is perhaps the most important aspect of the case, albeit not discussed at length from a statutory or a policy perspective. Applying appellate review of facts, the court concluded that:

> While the evidence considered by the bankruptcy court provided basis for plausible arguments on both sides of the five percent/ Robichaux issues, the court concludes that the bankruptcy court did not make any legal error in its findings, conclusions, and rulings on those issues. And, after reviewing the evidence, this court is unable to conclude that any of the bankruptcy court's findings of fact as to the subjects being discussed under this subheading were clearly erroneous.[42]

To fully use this opinion, the practitioner would have to obtain the briefing and the bankruptcy court's detailed findings of fact and conclusions of law. But, if the practitioner does so, he will have a strong district court opinion confirming that the market approach is not required by the law, and that the cramdown rate of interest continues to be a flexible, factual inquiry consistent with prior (and dated) Fifth Circuit precedent. While the appeal is being briefed as of this writing to the Fifth Circuit, it remains to be seen whether the appeal will survive equitable mootness. If it does, next year's Survey is sure to include an important opinion from the Fifth Circuit on the cramdown rate of interest for the first time in many years.

III. CHAPTER 13 PLANS

A. *In re* Pierrotti[43]

Pierrotti, seemingly an obvious case, is actually important in that it addresses a potential conflict or ambiguity concerning the modification of secured creditor's rights in Chapter 13. Specifically, Chapter 13 permits a plan with a maximum length of five years, but the debtor's proposed plan suggested paying the Internal Revenue Service's tax lien over a period of fifteen years. The debtor argued that section 1322(b)(2) and (5) permitted this result, by providing that a Chapter 13 plan may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence" and that it may "provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due."[44]

42. *Id.* at *5.
43. Pierrotti v. United States (*In re* Pierrotti), 645 F.3d 277 (5th Cir. 2011).
44. *Id.* at 279.

The circuit court applied straightforward statutory interpretation to conclude that the debtor could not repay the tax lien over a period of more than the maximum five year term of the plan:

> If we endorsed [the debtor's] reading of § 1322(b), then § 1322(d) (capping a Chapter 13 plan's lifetime at three or five years . . .) would never apply to a secured claim modifiable under § 1322(b)(2) because the debtor could always 'modify' the length of time for payments on the existing debt and then claim to 'maintain' payments according to that modification under § 1322(b)(5). We decline to interpret § 1322(b) in a way that would render § 1322(d) null and void as to such modified claims.[45]

With respect to the argument that section 1322(b)(5) provided for a cure of default and the maintenance of the claim, the problem was that the last payment was not due after the date on which the final plan payment would be due. As explained by the circuit, "[t]he due dates for [the debtor's] income taxes for 1994 and 2000, at issue here, have clearly passed, and those tax deficiencies are therefore debts that have already fully matured and were immediately due and payable before he even filed for bankruptcy. Section 1322(b)(5) is thus not applicable here."[46] Therefore, neither section 1322(b)(2), because it conflicted with section 1322(d), nor section 1322(b)(5), since the debt had already fully matured, were applicable, and the debtor could not repay the tax lien over a period of time of more than the five year maximum available length of the plan.

IV. COMPENSATION

A. *In re* ASARCO, LLC[47]

The practitioner will remember Judge Bohm's opinion from prior years loudly criticizing the compensation and fees paid to investment bankers. While *ASARCO* is not fully on point with Judge Bohm's opinion, it does represent a rare Fifth Circuit opinion on the compensation paid to third parties who deal with bankruptcy estate (separate from the estate's own professionals).

As part of a bankruptcy sale and auction process, the bankruptcy court authorized the debtor to reimburse qualified bidders for their due diligence expenses incurred in connection with the sale, which the bankruptcy court concluded was permissible under section 363 of the Bankruptcy Code. The asset at issue was unique: a multi-billion dollar judgment. Thus, "due diligence would entail highly sophisticated legal analysis—and thus substantial legal costs."[48] Among other things, the appellants argued that the bankruptcy court applied the incorrect standard, in that the more rigid requirements of section 503(b) of the Bankruptcy

45. *Id.* at 280.
46. *Id.*
47. ASARCO, Inc. v. Elliott Mgmt. (*In re* ASARCO, LLC), 650 F.3d 593 (5th Cir. 2011).
48. *Id.* at 598.

Code and the requirements for an administrative claim should have controlled, as opposed to section 363 of the Bankruptcy Code.

The circuit court began its analysis by considering section 363(b) of the Bankruptcy Code, which provides that a debtor may use, sell, lease, etc. property of the estate, other than in the ordinary course of business, after approval from the court. "In such circumstances, 'for the debtor-in-possession or trustee to satisfy its fiduciary duty to the debtor, creditors and equity holders, there must be some articulated business justification for using, selling, or leasing the property outside the ordinary course of business.'"[49] Importantly, the circuit noted that "[t]he business judgment standard in section 363 is flexible and encourages discretion."[50] In contrast, section 503(b) of the Bankruptcy Code imposes a significantly more rigid standard. The appellants noted that breakup fees are usually reviewed as administrative claims under section 503(b) of the Bankruptcy Code, and that the due diligence expenses here are closely analogous to breakup fees. The circuit was not persuaded by this argument:

> [T]he break-up fee provisions . . . significantly differ from the due diligence reimbursement fees at issue in this case. The break-up fees were to be paid only if the prospective bidder was unsuccessful. Here, in contrast, prospective (and qualified) bidders could be reimbursed regardless of whether they were ultimately successful. Moreover, in both *O'Brien* and *Reliant Energy* the bankruptcy court refused to approve the break-up fee in part due to the concern that the fee would "chill the competitive bidding process." No such concern arises in this context, where ASARCO sought to *increase* competition by providing bidders an incentive to undertake the costly but necessary due diligence.[51]

Accordingly, the circuit court agreed that section 363(b) applied, and that the business judgment standard governing said section—a standard that is significantly lower than the requirement for an administrative claim—was satisfied.[52] At the same time, the circuit appears to have limited its holding, by noting that it was the factual record that drove the result and that the factual circumstances of the case were unique and rare.[53] Thus, the opinion may have limited precedential value. Nevertheless, the opinion is important in that it recognizes that section 363(b) may be a route to what might otherwise be considered an administrative claim (since it is a postpetition claim), irrespective of the strict requirements provided by section 503(b) of the Bankruptcy Code or even of the requirements of section 328 of the Bankruptcy Code. And, because the circuit court agreed that section 363(b) is flexible and that it encourages discretion, there may well be situations where a debtor or those dealing

49. *Id.* at 601 (quoting *In re* Cont'l Air Lines, Inc., 780 F.2d 1223, 1226 (5th Cir. 1986)).
50. *Id.*
51. *Id.* at 602 (citations omitted).
52. *Id.* at 603.
53. *Id.*

with a debtor may find relief under section 363(b) without the necessity of proving an administrative claim.

V. DISCHARGE

A. *In re* Moye[54]

In re Moye is an unpublished decision from the Fifth Circuit. However, because it deals with a denial of discharge for failure to satisfactorily explain the loss of assets—which is a basis for denial of discharge on which there is not much binding precedent—the authors consider it important to bring this opinion to the attention of the practitioner, especially the practitioner specializing in consumer bankruptcies.

Of interest is that the debtors in question owned an entity, a limited liability company, against which an involuntary petition was granted, and which led to the debtors' personal bankruptcies, which were then consolidated with the corporate involuntary. That entity on its statement of financial affair listed income of more than $5 million in each of 2005 and 2006. Its schedules of assets and liabilities, however, disclosed assets of only $1.1 million and liabilities of only $2.5 million. The question, therefore, was where the assets had gone. As phrased by the circuit court, the debtors

> refused to explain in discovery where the assets had gone, instead referring inquiries to the bankruptcy trustee. At trial, Moye reiterated that the bankruptcy trustee "has all the records" but also suggested that one of his employees had caused him to lose "close to a million dollars" by paying multiple times for the same cars.[55]

The bankruptcy court denied a discharge under section 727 of the Bankruptcy Code, concluding that the debtors had failed to satisfactorily explain the loss of assets (the bankruptcy court denied discharge on other grounds as well; however, the circuit court considered only this basis in its opinion).[56]

The circuit court noted that its review was limited to determining whether the bankruptcy court committed clear error in its ultimate finding of fact. As concluded by the circuit court:

> The Moyes' bankruptcy schedules revealed that although their business made over $10 million in 2005 and 2006, they had only $1 million in assets to pay their debts in 2007. The only explanation Marvin Moye offered was that his employee had "sucked" a million dollars from his accounts and that he was inadvertently "paying twice and three times for the same car." Such general explanations, without documentation, are not satisfactory."[57]

54. Moye v. MRB Mgmt., LLC (*In re* Moye), 418 Fed. Appx. 303 (5th Cir. 2011).
55. *Id.* at 304.
56. *Id.*
57. *Id.* at 305.

This is an interesting opinion, not only for the burden it imposes on the debtor, but also because the loss of assets was primarily related to the corporate debtor. True, the equity of that corporate debtor was owned by the debtors, so in effect a loss of assets for the corporate debtor is a loss of value to the individual debtors. But section 727(a)(5) does not speak to a loss of value. Rather, it addresses "any loss of assets or deficiency of assets to meet the debtor's liabilities."[58] Moreover, the section speaks in terms of the "debtor's liabilities," yet the debtor whose assets were apparently lost without explanation was the corporate debtor, who had no discharge to obtain or to deny. Since the cases were not substantively consolidated, and the record makes no mention of *alter ego*, it appears that either the circuit court glossed over any potential issue with the identity of the debtor in question, or that the issue may have not have been raised and briefed. Or, perhaps the circuit court intentionally broadened the scope of section 727(a)(5) to include not only a debtor's own assets, but also the assets of any wholly owned company. And, if that is the result, then the same can be said of other requirements of section 727 of the Bankruptcy Code, such as preserving records, making certain transfers, concealing property of the entity, and the like.

In any event, debtors beware: you need to be prepared to explain the finances, and any potential losses, of wholly owned companies or your debtor client's personal discharge may be in question.

VI. EQUITABLE MOOTNESS

A. *In re* Idearc, Inc.[59]

Many practitioners, were concerned with the Fifth Circuit's 2010 opinion in *Scopac*[60] seemingly limiting the equitable mootness doctrine as it had been applied by the Fifth Circuit for many years, as the authors noted in last year's Survey.[61] Fortunately, the Fifth Circuit has confirmed that the doctrine remains alive and well, and the Fifth Circuit has applied the doctrine to dismiss as equitably moot an order confirming a Chapter 11 plan.

In *Idearc*, the bankruptcy court confirmed the Chapter 11 plan. The district court dismissed the appeal as equitably moot. The Fifth Circuit affirmed the district court's dismissal. As emphasized by the circuit court, "equitable mootness analysis recognizes that a point exists beyond which a court cannot order fundamental changes in reorganization actions."[62] This analysis is comprised of three factors:

---

58. 11 U.S.C. § 727(a)(5).
59. Spencer Ad Hoc Equity Committee v. Idearc, Inc. (*In re* Idearc, Inc.), 662 F.3d 315 (5th Cir. 2011).
60. Bank of N.Y. Trust Co. v. Pac. Lumber Co. (*In re* Scopac), 624 F.3d 274 (5th Cir. 2010).
61. *See* Joseph J. Wielebinski & Davor Rukavina, *Bankruptcy*, 64 SMU L. Rev. 49, 68 (2011).
62. *Idearc*, 662 F.3d at 318.

> (i) whether a stay has been obtained, (ii) whether the plan has been "substantially consummated," and (iii) whether the relief requested would affect either the rights of parties not before the court or the success of the plan. The ultimate inquiry is whether the court can grant relief without undermining the plan.[63]

Although a court has discretion regarding whether to dismiss a matter for equitable mootness, "a court cannot avoid its obligation to scrutinize each individual claim, testing the feasibility of granting the relief against its potential impact on the reorganization scheme as a whole."[64]

Typically, the focus is on the third factor, and on whether the court can grant meaningful relief. Here, the new postconfirmation common stock was publicly traded for well over a year postconfirmation, "in no small quantity of shares."[65] Reversal, therefore, would affect the financial rights of many persons relying on the plan and the confirmation order, who were not before the circuit court. The circuit court therefore had no hesitation in affirming the dismissal of the appeal of the confirmation order on equitable mootness grounds—likely to the great relief of many debtor attorneys who questioned the viability of the equitable mootness doctrine after *Scopac*.[66]

B. *In re* Scopac[67]

The authors of this Survey have in prior years noted several important cases from the Fifth Circuit, with Chief Judge Edith Jones as the author, which they and many commentators have criticized for what they viewed as inequitable and harsh remedies. As noted in this Survey, 2011 appears to have been the year when the circuit court backed away from these troubling rulings. Discussed in this Survey are the opinions in *In re Texas Wyoming Drilling, Inc.* and *Reed v. City of Arlington*.[68] Another important opinion is *In re Scopac*, which the authors discussed in a previous Survey and which is discussed above as potentially limiting the application of the equitable mootness doctrine.[69] The Fifth Circuit revisited the issue in 2011, albeit in an interesting way. As such, *In re Scopac* (the second opinion) represents another retreat from the circuit's recently criticized opinions and, as some other commentators have suggested, may represent a further erosion of the influence of Chief Judge Edith Jones in important bankruptcy opinions.

63. *Id.* at 318–19 (internal quotations and citations omitted).

64. *Id.* at 319.

65. *Id.* at 320.

66. *Id.*

67. Bank of N.Y. Trust Co. v. Pac. Lumber Co. (*In re* Scopac), 624 F.3d 274 (5th Cir. 2010).

68. Spicer v. Laguna Madre Oil & Gas II, LLC (*In re* Tex. Wyo. Drilling, Inc.), 647 F.3d 547 (5th Cir. 2011); Reed v. City of Arlington, 650 F.3d 571 (5th Cir. 2011) (en banc).

69. *See* Joseph J. Wielebinski & Davor Rukavina, *Bankruptcy*, 63 SMU L. Rev. 309, 316–18 (2010) (discussing previous opinion in Bank of N.Y. Trust Co., N.A. v. Official Unsecured Creditors' Comm. (*In re* Pac. Lumber Co.), 584 F.3d 229 (5th Cir 2009)).

As noted, the first *In re Scopac* opinion appears to have limited the breadth and scope of the equitable mootness doctrine. The affected party sought a rehearing *en banc*, much as the case had been in *Reed v. City of Arlington*. Rather unusually, the original panel, led by Chief Judge Edith Jones, *sua sponte* deemed the petition for rehearing *en banc* as a petition for panel rehearing.[70] It has been suggested that this *sua sponte* action was prompted by the *en banc* results of *Reed v. City of Arlington*, and a desire to avoid the same result, although it is important to note that this is mere conjecture. In any event, the *In re Scopac* panel revisited its original holding instructing the lower court to enter a judgment awarding a $29.7 million administrative priority claim. Instead, the circuit modified its holding and explained as follows:

> This statement might suggest that the district court has no choice but to award the Noteholders the full $29.7 million that they seek. We write to clarify that partial recovery may be justified if necessary to avert the concerns of the equitable mootness doctrine . . .
>
> . . . courts "may fashion whatever relief is practicable" for the benefit of appellants. Allowing the possibility of partial recovery obviates the need for equitable mootness. As explained in our original opinion, "so long as there is the possibility of 'fractional recovery,' the Noteholders need not suffer the mootness of their claims."[71]

Thus, the circuit court left the final application of the equitable mootness doctrine in the hands of the district court, and it will be interesting to see how that court applies the doctrine and how the circuit court rules on any future appeal that may be taken.

This opinion is interesting and important not because it contains anything revelatory. Rather, it is important because it is a *sua sponte* retreat, albeit a partial retreat only, from the harsh remedy imposed in the first opinion, ultimately recognizing that the doctrine of equitable mootness may indeed have relevance. In particular, the panel recognized that, "[w]hether a full award of the $29.7 million administrative priority claim would jeopardize the reorganized debtor's financial health, however, is an open question that the instant opinion intended to commit to the bankruptcy court on remand."[72] Thus, although the first opinion suggests that equitable mootness does not apply, the rehearing opinion leaves the issue open and, therefore, significantly undermines the bright line result of the first opinion—and is an important reminder to always check important opinions for potential subsequent refinements or modifications. It is also interesting to note the almost inescapable conclusion that the panel, acting *sua sponte*, recognized that the original result was too harsh and that the result might well have been different upon an *en banc* review, as had been the case in *Reed v. City of Arlington*.

70. *In re Scopac*, 649 F.3d at 322.
71. *Id.* (citations omitted).
72. *Id.*

VII. HOMESTEAD

A. *In re* McCombs[73]

In re McCombs addresses the intersection between the Texas homestead and the 2005 changes to section 522(p) of the Bankruptcy Code imposing the requirement that a debtor have owned his homestead for 1,215 days prior to filing.[74] The judgment creditor obtained a judgment against the debtor, and recorded an abstract of judgment against the debtor's homestead. The debtor filed his Chapter 7 petition prior to the full 1,215 day period having expired. Accordingly, the debtor was limited in his homestead exemption to $125,000. The trustee sold the house, and netted almost $400,000 in proceeds.

While the circuit court considered several issues, the most important one was whether the judgment lien conferred by the abstract of judgment would extend to the proceeds in excess of the debtor's $125,000 exemption. The bankruptcy court held that the lien, while unenforceable against a Texas homestead, did not prevent the perfection of the lien to the extent of proceeds in excess of the section 522(p)(1)(D) $125,000 cap, essentially ratifying the judgment lien against the excess proceeds.[75]

The circuit court reversed.[76] The circuit court noted that the basic rule in bankruptcy is that state law determines the extent of a creditor's interest in property. Under Texas law, the lien was unenforceable outside of bankruptcy. Although the lien was unenforceable, the circuit court noted that the lien might come into effect upon certain conditions, such as if the property or the proceeds cease being homestead.[77] The important point for the circuit was that the status of the property and of the lien were to be determined as of the petition date: "[i]t is undisputed that [the] house and lot were homestead property entitled to protection under Texas law at the time [the debtor] filed bankruptcy."[78] With respect to the application of section 522(p), the circuit court concluded as follows:

> Section 522(p) is a federal provision that operates to limit the debtor's exemptible interest in the property; it does not speak to H.D. Smith's interest. In the absence of controlling federal interests, the state characterization of the property prevails. The non-exempt excess proceeds from the subsequent sale of the homestead property during the bankruptcy proceeding became non-exempt by virtue of federal law, not state law. The bankruptcy laws that place a cap on the value of a homestead did not convert H.D. Smith's lien *on the homestead* from one that was unenforceable pre-petition to one that was enforceable *as to the homestead* post-petition. The purpose of § 522(p) is to limit the amount of a homestead exemption, thereby

---

73. Smith v. H.D. Smith Wholesale Drug Co. (*In re* McCombs), 659 F.3d 503 (5th Cir. 2011).
74. 11 U.S.C. § 522(p) (2010).
75. *In re McCombs*, 659 F.3d at 507.
76. *Id.* at 513.
77. *See id.* at 508–09.
78. *Id.* at 509.

increasing the size of the bankruptcy estate available to creditors. We can discern no indication that the intent of § 522(p) was to make an otherwise unenforceable lien on homestead property enforceable *instanter*. H.D. Smith should be accorded the same priority as a creditor that it would have enjoyed had the bankruptcy not occurred.[79]

Left unresolved is the fact that, under Texas law, homestead proceeds cease being exempt unless reinvested in a homestead within six months of the sale of the homestead, although the circuit court did note that the excess proceeds became nonexempt as a result of the application of federal law, and not state law. The homestead was sold, the debtor obtained his $125,000 cap, but the balance of the proceeds were not reinvested in a homestead. While the circuit court rooted its holding in the application of state law, and noted no intention on the part of section 522(p) to make enforceable what was unenforceable under state law, the fact of the matter is that this is exactly what occurred: the Bankruptcy Code trumped the state law's six month provision. Of additional interest is the question, with particular reference to the circuit court's holding that the status of the lien is to be determined as of the petition date, of what role, if any, section 552 of the Bankruptcy Code plays. After all, one way to look at the situation is that the excess proceeds were acquired by the estate postpetition, and an interest in land typically extends to after acquired property and proceeds under section 552.

The result, while arguably harsh to the creditor, complies with the *pro rata* distribution policy of the Bankruptcy Code and the intent of Congress in imposing the 1,215 day rule. As such, it is a good example of policy and purpose addressing an uncertain statutory question. In fact, an alternate ruling might enable a debtor to grant a favored creditor, such as a relative, a lien on a homestead that would not be enforceable prior to bankruptcy, but would provide a windfall in the event bankruptcy was filed.

VIII. INJUNCTIONS

A. *In re* Stewart[80]

In re Stewart is another opinion apparently stemming from the wave of mortgage documentation and accounting problems that many judges, practitioners, commentators, and governmental agencies have described. Here, the bank with the mortgage on the house of an "elderly widow" overstated its proof of claim by more than $10,000.[81] Part of the problem was the bank's highly automated computer tracking program which, in this case, led to such things as calculating amounts due differently than the loan documents required, charging late fees with no notice to the debtor, charging for inspections that were plainly erroneous, and charging

79. *Id.*
80. Wells Fargo v. Stewart (*In re* Stewart), 647 F.3d 553 (5th Cir. 2011).
81. *Id.* at 554–55.

for attorney's fees and broker opinions without substantiating documentation.

Because proofs of claim are *prima facie* valid, and rarely do debtors incur the burden and expense to engage in an accounting, and because the bank had been found to have had similar systematic problems in that court before, the bankruptcy court concluded that the bank's actions were "a threat to the integrity of the bankruptcy system," and that action was also appropriate "to prevent other errors from evading review."[82] Accordingly, the bankruptcy court issued an injunction ordering the bank: "(1) to audit every proof of claim filed in the district . . . ; (2) to provide a complete loan history on every account and to file that history with the appropriate court; and (3) to amend . . . proofs of claim already on file to comply . . . ."[83] The United States Trustee supported the bankruptcy court's injunction, and defended it on appeal.

The circuit court vacated the injunction.[84] The basis offered by the bankruptcy court for the power to issue its injunction was section 105(a) of the Bankruptcy Code. The circuit court, however, looked to standing and jurisdiction. With respect to this particular debtor, because the harm had happened in the past and was not likely to be imminent with respect to her, there was no "case or controversy" regarding injunctive relief. Thus, the debtor lacked standing and, because the adjudication of the claim in the present case did not relate to other claims and estates, the bankruptcy court did not have the jurisdiction to issue the injunction as part of its claims allowance powers.[85]

Separately, the circuit court considered whether the injunction was appropriate under "'the inherent power of the court to protect its jurisdiction and judgments and to control its docket.'"[86] The circuit court rejected this argument as well, holding that, although the bank's deficiencies cast doubt on other claims in other cases, "misdeeds in other cases can be addressed by the judges in those cases. If the case-by-case process, with the discipline of developed jurisprudence, is thought to be inadequate, there remains the rulemaking authority."[87] The circuit court did not address the precise issue, or address whether the bankruptcy court possessed this jurisdiction and power in other cases. Instead, and without offering much guidance, the circuit court concluded that:

> We do not have a pattern of conduct that flouts a judicial ruling in subsequent cases. An injunction has not been shown to be sufficiently necessary.
>
> We need not here undertake to draw bright boundaries to the well-established power of a court to correct abuses of its process. We say

82. *Id.* at 556.
83. *Id.* (internal quotations omitted).
84. *Id.* at 558.
85. *Id.* at 556–57.
86. *Id.* at 557 (quoting Ferguson v. Mbank Houston, N.A., 808 F.2d 358, 360 (5th Cir. 1986)).
87. *Id.*

> only this: the injunction here was outside that boundary. The issued injunction ranges far beyond the dimensions of this case to police a range of cases untested here by the adversary process. Its specific commands are not for the benefit of Ms. Stewart, whose injuries are fully remedied without the injunction. Rather, the injunction is aimed at other cases in which Wells Fargo has appeared or might appear before the bankruptcy courts. While justification for the bankruptcy court's frustration is plentiful, its injunction lacks jurisdictional legs.[88]

The opinion is perhaps not of great precedential value. But, it is a reminder that bankruptcy courts, even if they are correct that there is abuse and even if they are acting properly to try to correct that abuse, should be cautious not to become public watchdogs or "bankruptcy police"—no matter how justified this might be—and must remain mindful of their limited jurisdiction. Otherwise, more decisions like *Stern v. Marshall* might result. At least the Fifth Circuit in *Stewart* did not take the opportunity to explore in-depth the bankruptcy court's jurisdictional ability to issue injunctions, instead limited its holding to the injunction at hand. Had the Fifth Circuit done so, the result might have been of broader concern to bankruptcy jurisdiction and bankruptcy practitioners.

IX. JUDICIAL ESTOPPEL

A. Reed v. City of Arlington[89]

Readers of this Survey in prior years will recognize *Reed v. City of Arlington* as a Fifth Circuit opinion criticized by the authors of this Survey and by many bankruptcy practitioners and judges. The present opinion—an *en banc* review by the Fifth Circuit—reserves the prior panel's opinion through a thirteen to three opinion.[90]

The debtor obtained a prepetition judgment for more than $1 million. While that judgment was on appeal to the Fifth Circuit, the debtor and his wife filed a Chapter 7 petition. On his schedules, the debtor failed to disclose the judgment, the cause of action, or the associated legal fees. The debtor failed to inform his non-bankruptcy attorney of the bankruptcy filing. Ultimately, the Chapter 7 estate was declared a "no asset" estate and the debtor received a discharge. Meanwhile, the Fifth Circuit affirmed the underlying judgment, but remanded for a recalculation of damages.[91]

Thereafter, the debtor informed his non-bankruptcy attorney of the bankruptcy filing. That attorney promptly notified the Chapter 7 trustee of the judgment. The trustee reopened the case, succeeded in revoking the debtor's discharge, and substituted herself in the underlying litigation as the real party-in-interest. The defendant, now learning of the bank-

88. *Id.* at 558.
89. Reed v. City of Arlington, 650 F.3d 571 (5th Cir. 2011) (en banc).
90. *Id.* at 572, 579.
91. *Id.* at 573.

ruptcy case, promptly moved for the application of judicial estoppel, to prevent the trustee from collecting on the judgment due to the debtor's failure to disclose the judgment on his sworn bankruptcy schedules. The district court held that, while the debtor should be estopped from collecting on the judgment, the trustee, having taken no part in the deception and representing the interests of innocent creditors, should not be similarly estopped.[92]

On appeal, the Fifth Circuit reversed.[93] The panel analyzed judicial estoppel and noted that it existed to protect the *courts*, and not necessarily the *litigants*, from misrepresentations and litigation games. Thus, to the panel, it did not matter that the trustee and the creditors were innocent: the judicial system had been abused and the application of judicial estoppel should be invoked to prevent anyone from gaining as a result of the abuse of the judicial process. That holding was a surprise to bankruptcy trustees and practitioners, and generated significant discussion—most of it criticizing the panel for punishing an innocent trustee and innocent creditors on the one hand, while enabling a guilty defendant to escape its already adjudicated liability.

Sitting *en banc*, the Fifth Circuit vacated and reversed the panel.[94] In a nutshell, the full circuit held that, "absent unusual circumstances, an innocent trustee can pursue for the benefit of creditors a judgment or cause of action that the debtor fails to disclose in bankruptcy."[95] The opinion is grounded in fairness and in equity, which is not surprising since the whole purpose of judicial estoppel is to ensure equity, through a flexible approach. "It is an equitable doctrine invoked by a court at its discretion to protect the integrity of the judicial process."[96] As further explained:

> Here, we apply judicial estoppel "against the backdrop of the bankruptcy system and the ends it seeks to achieve." These ends are to "bring about an equitable distribution of the bankrupt's estate among creditors holding just demands," and to "grant a fresh start to the honest but unfortunate debtor." Therefore, judicial estoppel must be applied in such a way as to deter dishonest debtors, whose failure to fully and honestly disclose all their assets undermines the integrity of the bankruptcy system, while protecting the rights of creditors to an equitable distribution of the assets of the debtor's estate.[97]

Because the doctrine is rooted in equity, it must be equitably and flexibly applied so as to ensure that its purpose—equity—is in fact served. "Because judicial estoppel is an equitable doctrine, courts may apply it flexibly to achieve substantial justice."[98] Courts must strive to fashion a

92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.* at 574 (internal quotation omitted).
97. *Id.* (citations omitted).
98. *Id.* at 576.

remedy that does not result in inequity by punishing the innocent, which is the antithesis of equity in the first place. This is exactly the result required by the panel's opinion, which, to many commentators, appears to have been more than the full circuit could stomach from a purely equitable review.

The full circuit also noted that "[j]udicial estoppel, as an equitable remedy, must be consistent with the law."[99] Once the debtor files his petition, the judgment became property of the estate, and the debtor had no legal ability to divest the estate of its property, such ability residing solely with the trustee. The trustee's management of estate property, and her duties with respect to that property, were "not affected by [the debtor's] failure to disclose the asset, and it was not extinguished by the conclusion of the bankruptcy case."[100] Indeed, as noted by the circuit, "a bankruptcy case [can even] be reopened in order to administer assets of the estate."[101] Thus, to apply judicial estoppel to divest the estate of an asset through the actions of the debtor, when the debtor had no legal ability to divest the estate of the asset, would be inconsistent with the Bankruptcy Code and would, in a very real way, ratify the illegal actions of the debtor.

Therefore, the full circuit concluded that, while estopping the intentionally wrongdoing debtor was fully justified and appropriate (a conclusion that is difficult to disagree with), estopping the trustee was not appropriate under both the equities and the law.[102] Indeed, to estop the trustee would convert a flexible, equitable doctrine into one of inequity that punishes the innocent and permits the defendant, adjudicated to have been liable for more than $1 million, to obtain a windfall by escaping its liability.

Reed v. City of Arlington is an important opinion, and one that is sure to have substantial ramifications, even if not directly, since a similar fact pattern is unlikely (while debtors frequently omit assets from their schedules, a $1 million judgment, so intentionally wrongful a debtor, and other relevant facts are not frequent). It is important because it reaffirms the critical role of equity in the bankruptcy process, and the need to employ equity so as to protect the innocent. It is important for trustees, since it removes a potentially serious and fatal bar to their ability to administer their estates, and reaffirms that a debtor cannot be judicially permitted to divest an estate of its assets. And, more subtly, it is important because, together with various other opinions (including *Texas Wyoming* discussed in this Survey), it is a strong signal that the trend of some of the "harsh" bankruptcy opinions issued by the Fifth Circuit in the previous years, frequently involving one particular Fifth Circuit judge, may be coming to an end, with a more flexible, equitable approach becoming more favored.

99. *Id.* at 574.
100. *Id.* at 575.
101. *See id.* (citing 11 U.S.C. § 350(b)).
102. *Id.* at 574–75.

At least as the authors of this Survey would argue, that would be the result most consistent with the Bankruptcy Code and the Bankruptcy Rules.

B. Texas Wyoming Drilling, Inc.[103]

Discussed above is the Fifth Circuit's important *Texas Wyoming* opinion insofar as the opinion addresses the retention of claims under a Chapter 11 plan and the postconfirmation plaintiff's standing to prosecute the claims. The opinion also addresses judicial estoppel, which is a frequent defense asserted by postconfirmation defendants as to why the claim against them should be dismissed.

As noted above, in *Texas Wyoming* the circuit confirmed that the fundamental purpose of the various plan retention doctrines is to ensure that those voting on the plan—including those who may be sued even after the confirmation of the plan—have adequate and correct information so as to make an informed decision on the plan.[104] The circuit court also held that a court may construe the disclosure statement together with the plan in making this determination.[105]

Reviewing the defendants' argument, the circuit court noted that one of the requirements for judicial estoppel is that the plaintiff take a "clearly inconsistent position[ ]."[106] This has happened in previous Fifth Circuit and lower court cases, usually through silence: by not revealing the existence of causes of action that the debtor knows exist, at the precise time when the debtor should reveal those causes of action to its stakeholders as they vote on a plan, the debtor's silence has been construed as a representation that the causes of action do not exist. In *Texas Wyoming*, however, the disclosure statement clearly revealed the existence of upwards of $4 million in fraudulent transfer claims against (unnamed) former shareholders, and that the debtor intended to prosecute these claims postconfirmation for the benefit of creditors. Thus, as concluded by the circuit court:

> The defendant's argument founders on the first requirement because TWD did not take clearly inconsistent positions. As explained above, TWD's plan and disclosure statement retained the right to pursue the Avoidance Actions. Because TWD explicitly retained the same claims against the defendants that the trustee is now pursuing, there is no inconsistency in its position.[107]

This is a simple, elegant, and correct holding: legal formalities aside, if the purpose of judicial estoppel is to protect against "laying behind the log" while valuable rights are potentially lost, it cannot be judicial estop-

103. Spicer v. Laguna Madre Oil & Gas II, LLC (*In re* Tex. Wyo. Drilling, Inc.), 647 F.3d 547 (5th Cir. 2011).
104. *Id.* at 551.
105. *Id.*
106. *See id.* at 552.
107. *Id.* at 552–53.

pel when the debtor tells the creditors of the existence of causes of action and that they may be sued postconfirmation even if they vote for the plan. That is the very opposite of a representation through silence.

X. JURISDICTION

A. STERN V. MARSHALL[108]

The bankruptcy practitioner is undoubtedly already familiar with *Stern v. Marshall*—one of the Supreme Court's most important decisions on bankruptcy jurisdiction since its 1982 *Northern Pipeline* opinion. Many articles have already been written about the opinion, and it has been discussed at numerous bar and CLE functions. Giving it a full and detailed analysis in the confines of this Survey is impossible. Nevertheless, given its importance, it is critical that every practitioner have at least a basic understanding of its holding and its logic. It is also important that the practitioner consult developments in the coming years concerning the implications and interpretation of *Stern v. Marshall*, as courts, commentators, and attorneys begin to cope with its broader meaning and its application.

The case has an unusually colorful background for a bankruptcy opinion, although its procedural history is complicated. The following is a brief summary. Vickie Marshall, also known as Anna Nicole Smith, married a man much richer and older than her. When he died, he left her out of his will. She then filed suit in Texas court against her dead husband's son, alleging that the son had fraudulently induced the husband to leave her out of his will. She later filed a bankruptcy petition in California. The son filed a proof of claim in her case for defamation, and an adversary proceeding seeking to have the defamation claim declared nondischargeable. She then filed a counterclaim against the son, asserting the same underlying allegations of fraudulent inducement and tortious interference. The bankruptcy court first entered summary judgment dismissing the son's defamation claim. After that claim had been dismissed, the bankruptcy court liquidated the counterclaim against the son, awarding more than $400 million in damages. Eleven years later, the case made it to the Supreme Court for the second time.

The issue was simple: did the bankruptcy court have jurisdiction to adjudicate the state common law cause of action for tortious interference? Prior to the Supreme Court, the issue was phrased more in terms of whether the bankruptcy court's jurisdiction was core or non-core. The district court concluded that, although the counterclaim fell within the literal language of 28 U.S.C. § 157(b)(2)'s definition of core proceedings, the counterclaim was not a core proceeding pursuant to the Supreme Court's *Northern Pipeline* decision.[109] Thus, the district court treated the judgment as proposed findings of fact and conclusions of law. The district

108. Stern v. Marshall, 131 S. Ct. 2594 (2011).
109. *Id.* at 2596.

court, reviewing the record, then entered a judgment much like the bankruptcy court judgment (albeit for less), concluding that the son had tortiously interfered with the inheritance (this is even though a Texas jury concluded otherwise, which conclusion the district court refused to give preclusive effect).[110]

The Supreme Court agreed that the counterclaim was a core proceeding within the literal meaning of the statute.[111] However, that was not the end of the inquiry because, even though the counterclaim may have fallen within the language of the statute, the constitutional question still had to be addressed: "[t]he Bankruptcy Court in this case exercised the judicial power of the United States by entering final judgment on a common law tort claim, even though the judges of such courts enjoy neither tenure during good behavior nor salary protection."[112] This implicated the requirements of Article III of the Constitution, and the same issues as addressed in *Northern Pipeline.* Rather than take any of the several approaches offered by the parties that would avoid the constitutional question, the Court went straight to the constitutional question concluding that, even though the counterclaim was statutorily core, the statute, as applied to the claim, was unconstitutional.[113]

The Court noted that section 157 of the Judiciary Code is not jurisdictional. Rather, the section "allocates the authority to enter final judgment between the bankruptcy court and the district court."[114] The Court also noted that the protections of section 157 of the Judiciary Code can be waived, as it concluded the son had done here by submitting his defamation claim (arguably a personal injury claim) to the bankruptcy court. Thus, the son had consented to the bankruptcy court's adjudication of his defamation claim, and the bankruptcy court had jurisdiction to enter a final judgment on that claim, notwithstanding the argument that the claim, as a potential personal injury claim, may only be tried in the district court under the statute. This is a positive aspect of the *Stern v. Marshall* case by reinforcing that jurisdictional arguments are not to be used as a game to revisit after trial an unfavorable result. However, that the bankruptcy court had jurisdiction over the claim did not mean that the bankruptcy court also had jurisdiction over the counterclaim.

As noted above, the bankruptcy court, in adjudicating the tortious interference claim, exercised the judicial power of the United States to adjudicate a state-derived, common law claim. Article III of the Constitution vests the "judicial power" of the United States only in the Article III judiciary. Congress may refer certain types of cases to a non-Article III court, if the cases involve "public rights." But this exception cannot be permitted to swallow the rule. The "public rights" doctrine

110. *Id.* at 2602.
111. *Id.* at 2604.
112. *Id.* at 2600.
113. *Id.* at 2608.
114. *Id.* at 2607.

does not "permit[ ] a bankruptcy court to adjudicate a state law suit brought by a debtor against [an entity] that had not filed a claim against the estate."[115] But, just because one of the parties is the debtor or the estate in bankruptcy does not convert the claim or the case into a "public rights" claim or case. True, the "public rights" doctrine does not require the federal government to be a party to the suit. But, the exception is limited "to cases in which the claim at issue derives from a federal regulatory scheme, or in which resolution of the claim by an expert government agency is deemed essential to a limited regulatory objective within the agency's authority."[116] The tortious interference claim was neither of these: "[t]he claim is instead one under state common law between two private parties. It does not 'depend[ ] on the will of Congress;' Congress has nothing to do with it."[117] Thus:

> What is plain here is that this case involves the most prototypical exercise of judicial power: the entry of a final, binding judgment *by a court* with broad substantive jurisdiction, on a common law cause of action, when the action neither derives from nor depends upon any agency regulatory regime. If such an exercise of judicial power may nonetheless be taken from the Article III Judiciary simply by deeming it part of some amorphous "public right," then Article III would be transformed from the guardian of individual liberty and separation of powers we have long recognized into mere wishful thinking.[118]

That the son had filed a proof of claim did not matter. This was because the claim for defamation in no way affected the nature of the counterclaim for tortious interference—the two claims were not two sides of the same coin. The situation may be different when the adjudication of the counterclaim or other claim is a part of, or is necessary to, adjudicating the claim against the estate. With a preference, for example, the Court noted that it is not possible to adjudicate the claim against the estate without adjudicating the preference claim.[119] But that was not the case with respect to the tortious interference claim, since the two claims (defamation and tortious interference) were two separate, independent claims, where neither was dependent on, or based on, the other.

Of additional importance, the Court held that, even if a matter arguably falls within the "public rights" doctrine, the presumption is still in favor of a trial by an Article III court.[120] This presumption could have far reaching effects. However, the Court did comment that its holding was narrow. The Court was not suggesting that the bankruptcy court, or district court, would have no jurisdiction over all counterclaims. All that it was holding, in the narrow context of the case before it, was that the

115. *See id.* at 2611.
116. *Id.* at 2613.
117. *Id.* at 2614 (citation omitted).
118. *Id.* at 2615.
119. *See id.* at 2616.
120. *See id.* at 2618.

bankruptcy court lacked jurisdiction over a counterclaim based on a state, common law claim that is independent from the claim asserted against the debtor's estate.[121]

The holding is arguably narrow. But what is perplexing is why the Supreme Court undertook the jurisdictional analysis at all. As noted, there were several ways that the Court could have reversed the judgment without addressing the constitutional issue. Moreover, the district court had treated the bankruptcy court's judgment as a proposed judgment, and proceeded to enter its own judgment after a *de novo* review. Why could the district court, as an Article III court, not do that? Or, because the claim against the estate had already been dismissed, leaving only the counterclaim, why was the issue not one of supplemental jurisdiction? What commentators critical of *Stern v. Marshall* note is that, even if the Court was correct, it could have avoided the issue (as is the standard practice, if a less difficult means exists so as to avoid the Constitutional question). That it proceeded straight to the constitutional issue is viewed by some as signaling a potential trend in limiting bankruptcy court jurisdiction, which is already complicated enough. On the other hand, why did the bankruptcy court go out on a limb, over a state, common law claim, after it had disposed of the defamation claim, in a very high profile case with well-armed litigants? This might be a good reminder to bankruptcy courts not to test their jurisdiction too far, since they are courts of limited jurisdiction, created under Article I of the Constitution, and they (and bankruptcy practitioners) may not like the results of the test.

Ultimately, it remains to be seen how *Stern v. Marshall* will play out in the lower and intermediate courts. That the Supreme Court was correct in its conclusion is hard to disagree with, although it could have avoided the issue altogether. Perhaps it is that intangible thing—a view that the Court was "out to get" bankruptcy jurisdiction—that has sparked much of the commentary on the case. And the Court noted correctly that practical considerations of efficiency and the like cannot displace the Constitution. After all, it would be quite practical, convenient, efficient, and arguably more effective for the police to arrest anyone, at any time, with no probable cause merely because the police have a hunch that the person was engaged in illegality. There is no question that *Stern v. Marshall* will make the job of the bankruptcy court and the bankruptcy practitioner more difficult. Much litigation and resources will be spent in the near term weighing, applying, and testing the full import of *Stern v. Marshall*. Some cases will have to be brought in district court, or state court. Main bankruptcy cases will take longer to bring to finality. Piecemeal litigation will result. Costs will go up. These are not hypothetical concerns, although perhaps some commentators have overstated the practical effects of these concerns, because cases of the type are not all that frequent. It is also important to remember that the Court could have done worse, by questioning the jurisdiction of the bankruptcy court to adjudicate the def-

121. *Id.* at 2611.

amation claim, which is also a state derived, common law claim. The Court, for several reasons, confirmed the bankruptcy court's jurisdiction to adjudicate that claim by final judgment, and this should not be overlooked or forgotten.

The case is not a slap to bankruptcy judges or practitioners. The case is instead a slap to Congress. And, it should remind everyone that the jurisdictional issues in bankruptcy—which have cost a huge amount of time, money, appeals, and resources in the past thirty years—could easily be solved if Congress would elevate bankruptcy judges to Article III status, even if their jurisdiction remained limited just to bankruptcy matters. The question of what good reason there is for not doing so remains unanswered.

B. *In re* Apex Long Term Acute Care[122]

Practitioners and courts have already been struggling with both the narrow and the broader implications of *Stern v. Marshall*, which will no doubt continue well into the future. One recent opinion applying and construing *Stern v. Marshall* is from Judge Isgur, where the court considered the question of its jurisdiction in a case where the trustee had filed a preference action against a creditor who did not file a proof of claim. Interestingly, the court raised the issue *sua sponte*, pursuant to its duty to ensure its own jurisdiction prior to proceeding. Since the creditor did not file a proof of claim, thereby not submitting itself to the court's jurisdiction, did the court have jurisdiction over the preference action anyway in light of *Stern v. Marshall*? As phrased by the court:

> Preferential transfers are among the most difficult types of claims to classify. On the one hand, the right to avoid preferential transfers is established by the Bankruptcy Code itself, not by state law. The recovery of preferences has long been considered an integral part of the bankruptcy process. . .
>
> . . . Conversely, Supreme Court precedent seems to indicate that the public rights doctrine—the major exception allowing non-Article III tribunals to adjudicate disputes—does not apply to preferential transfer actions when the defendant has not filed a proof of claim in the bankruptcy case.[123]

Ultimately, the court concluded that it had jurisdiction over the preference action even though the defendant had not filed a proof of claim, notwithstanding the holding of *Stern v. Marshall*.[124]

The court began by noting that, even prior to *Stern v. Marshall*, a preference defendant who did not file a proof of claim had a jury right. Reviewing extensive precedent, the court noted that "[t]he public rights doctrine originally applied to disputes between an individual and the gov-

122. *In re* Apex Long Term Acute Care-Katy L.P., 465 B.R. 452 (Bankr. S.D. Tex. 2011).
123. *Id.* at 455.
124. *Id.* at 464.

ernment. Because such disputes 'could only be brought if the Federal Government chose to allow it by waiving sovereign immunity,' Congress could choose to have the disputes decided by a non-Article III tribunal."[125] In *Stern v. Marshall*, the Supreme Court cautioned that what makes a right a public right "'is that the right is integrally related to particular federal government action.'"[126] Nevertheless, the court concluded that "the resolution of certain fundamental bankruptcy issues falls within the public rights doctrine."[127] The court explained as follows:

> Although the Supreme Court's opinion in *Stern* explicitly did not reconsider the public rights framework for bankruptcy, it did emphasize that its ruling was "narrow" and that "we are not convinced that the practical consequences of such limitations on the authority of bankruptcy courts to enter final judgments are as significant as Vickie and the dissent suggest." Because the opinion assumes that its impact on the day-to-day activities of bankruptcy courts will not be radical, this Court concludes that after *Stern*, most fundamental bankruptcy matters must fall within bankruptcy courts' constitutional authority. *Katz* provides guidance as to which matters are fundamental: "Critical features of every bankruptcy proceeding are the exercise of exclusive jurisdiction over all of the debtor's property, the equitable distribution of that property among the debtor's creditors, and the ultimate discharge that gives the debtor a 'fresh start' by releasing him, her, or it from further liability for old debts." Many of these critical features are disputed matters, and they could be decided by the bankruptcy courts only through the public rights doctrine.[128]

Not all bankruptcy matters fall within the public rights doctrine. Rather, as *Stern v. Marshall* itself recognized, "'the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process.'"[129] Reviewing prior precedent and the history of the bankruptcy laws in detail, the court concluded that a preference action stems from the bankruptcy itself and is decided primarily pursuant to the court's *in rem* jurisdiction.[130] As artfully explained by the court in addressing the nature of a preference action, "preference actions are decided pursuant to bankruptcy courts' *in rem* jurisdiction over the estate. This is because, under the Bankruptcy Code, amounts that are preferentially transferred were always really part of the bankruptcy estate."[131] As further expanded by the court:

> In essence, the effect of § 547 is to define the *res* as of 90 days before the petition (one year for transfers to insiders). If the antecedent 90-day *res* was distributed inequitably, the Bankruptcy Code merely

125. *Id.* at 457.
126. *Id.* (quoting *Stern*, 131 S. Ct. at 2613).
127. *Id.*
128. *Id.* at 458 (quoting Cent. Va. Cmty. College v. Katz, 546 U.S. 356, 363–64 (2006)).
129. *Id.* at 460 (quoting *Stern*, 131 S. Ct. at 2618).
130. *Id.* at 461–64.
131. *Id.* at 463.

provides for its equitable distribution. The situation is closely analogous to the recovery of a post-petition transfer under § 549. Section 549 restores to the estate the *res* as it existed on the petition date; § 547 restores the *res* as it existed 90 days before the petition date. There is no serious question that a § 549 cause of action is within the bankruptcy court's *in rem* authority.[132]

The key, therefore, is that the court is exercising *in rem* jurisdiction, over a *res* that is undeniably within its constitutional authority. The other key is the Supreme Court's 2006 opinion in *Katz*, which is central to Judge Isgur's analysis, including his view that *Katz* "broke significantly" from prior precedent, or perhaps prior dicta. What this likely means, at least under Judge Isgur's opinion, is a future showdown regarding which line of Supreme Court precedent will prevail: the multiple prior, albeit older opinions arguably more on point, or the more recent *Katz* opinion, also on point. Or, does *Stern v. Marshall* implicitly reverse or at least modify *Katz*? Each practitioner, and each district court judge wishing to avoid having his or her court swamped with preference and a whole host of other avoidance actions, should hope that the question will ultimately be resolved along the lines of Judge Isgur's excellent and scholarly opinion. If not, and if Congress continues to refuse to consider Article III status for bankruptcy judges, the practice will change drastically indeed.

XI. RECHARACTERIZATION

A. *In re* Lothian Oil Inc.[133]

In *Lothian Oil*, the circuit, through Chief Judge Edith Jones, phrased the question as follows: "whether the bankruptcy court may recharacterize a claim as equity rather than debt—raises a novel question of law on which this court has yet to speak."[134] The bankruptcy court, in the context of an objection to claim, concluded that the claims at issue "assert[ed] common equity interests at best" (apparently not through an adversary proceeding).[135] The district court reversed in part, since the claimant was not an insider and the district court concluded that recharacterization could not be used to convert an alleged debt of a non-insider into an equity interest. Thus, "[t]he district court applied a *per se* rule to prohibit bankruptcy courts from recharacterizing contributions from anyone but corporate insiders."[136]

The circuit court noted that state law normally applies to the allowance of a claim and that, if the claim is contrary to state law, the bankruptcy court may not allow the claim. Yet, for some types of rights under state law, an outright disallowance might not be appropriate, because the claimant may have some right against the debtor. Thus, recharacteriza-

132. *Id.*
133. Grossman v. Lothian Oil Inc. (*In re* Lothian Oil Inc.), 650 F.3d 539 (5th Cir. 2011).
134. *Id.* at 541.
135. *Id.*
136. *Id.* at 542.

tion fills this role. The circuit court noted that other courts that have reviewed the issue grounded the ability to recharacterize in the bankruptcy court's equitable powers, including section 105(a) of the Bankruptcy Code. The circuit court also noted that resort to these powers is unnecessary, given the circuit's view that state law permits recharacterization. With respect to the factors governing the recharacterization inquiry, the circuit court endorsed its eleven-part test laid down in 1981 in its *Jones* opinion for non-bankruptcy tax law cases, which the circuit court concluded should also now apply to recharacterization in bankruptcy, which had been the practice anyway.[137]

While the opinion is the correct result and comports with the large majority of the law, the route the circuit court employed to arrive at its conclusion is strange and appears to have been guided by policy considerations more than anything. For one thing, the circuit court merely concludes that Texas law would permit a recharacterization in appropriate circumstances, although the court cites to no Texas precedent whatsoever, and although it fails to explain at all what Texas cause of action or type of relief would be involved. It is purely a conclusory statement. The circuit court clearly wanted to avoid the question of whether the bankruptcy court's equitable powers authorized recharacterization, although that may have been the more relevant question. Also strange is the absence of any reference to the Supreme Court's 1939 opinion in *Pepper v. Litton*, in which the Court endorsed the treatment of alleged debt as an equity contribution in the appropriate instance.[138] Similarly absent is the Fifth Circuit's 1993 opinion in which the circuit court noted that "the combination of undercapitalization and the insider loan may allow the bankruptcy court to recharacterize the loan as a capital contribution," although this was *dicta*.[139] And, perhaps most significantly, if the basis for recharacterization is state law, what if the applicable state law turns out to not provide for such a cause of action or remedy?

XII. RES JUDICATA

A. Texas Wyoming Drilling, Inc.[140]

Discussed above for purposes of postconfirmation claim prosecution under *United Operating* and for purposes of judicial estoppel is the Fifth Circuit's opinion in *Texas Wyoming*. That opinion also dealt with the defendants' argument that *res judicata* barred the trustee's postconfirmation prosecution of claims. It is discussed here because of the novel approach adopted by the Fifth Circuit to the *res judicata* issue.

137. *See id.* at 544 (citing and construing Jones v. United States, 659 F.2d 618, 622 n. 12 (5th Cir. 1981)).

138. Pepper v. Litton, 308 U.S. 295, 309–310 (1939).

139. Summit Coffee Co. v. Herby's Foods, Inc. (*In re* Herby's Foods, Inc.), 2 F.3d 128, 132 (5th Cir. 1993).

140. Spicer v. Laguna Madre Oil & Gas II, LLC (*In re* Tex. Wyo. Drilling, Inc.), 647 F.3d 547 (5th Cir. 2011).

In several prior opinions, the Fifth Circuit reviewed the issue of *res judicata* as it applied to claims retention under a Chapter 11 plan.[141] In these prior opinions, however, the circuit reviewed the well-established elements of *res judicata* and whether the plan sufficiently complied with those requirements. In *Texas Wyoming*, however, the circuit looked not to the sufficiency of the plan, but rather to the language of the confirmation order.[142] This is because the appellee/trustee argued that, just like in non-bankruptcy litigation where even a final judgment can carve out a claim for future litigation, thereby preserving the claim from *res judicata*, the same should be possible in bankruptcy, since it is the confirmation order that is deemed to be the first judgment for *res judicata* purposes. The circuit agreed, holding as follows:

> *Res judicata* does not apply here. The defendants have not pointed to a prior final judgment on the merits of the Avoidance Actions. A judgment that expressly leaves open the opportunity to bring a second action on specified parts of the claim or cause of action that was advanced in the first action should be effective to forestall preclusion. *Res judicata* does not apply where a claim is expressly reserved by the litigant in the earlier bankruptcy proceeding. The confirmation order here provided that TWD retained the right to demand, enforce, and litigate Estate Actions which include the Avoidance Actions.[143]

Thus, because the confirmation order clearly preserved the avoidance actions for future litigation notwithstanding the confirmation of the plan, *res judicata* simply did not apply. Although seemingly simple and logical on its face, the holding is of importance because it looks not to the specific language of the plan, which may arguably be defective in some cases, but rather to the language of the confirmation order. Since any decent Chapter 11 confirmation order should include a reservation of claims provision, it would appear that the *res judicata* inquiry would be readily satisfied (although it is important to note that this does not relieve the debtor or the plan proponent from the potential affects of judicial estoppel and *United Operating*'s standing requirements).

XIII. CONCLUSION

As noted, 2011 has been an important year nationally and, even more so, within the Fifth Circuit, with respect to bankruptcy precedent. Other lower court opinions continue to make their way to and through the Fifth Circuit, and courts continue to struggle to apply the lessons of *Stern v. Marshall* and to define its boundaries, which will likely make for a jurisprudentially interesting and important 2012 and beyond. At the same

141. *See, e.g.*, Howe v. Vaughan (*In re* Howe), 913 F.2d 1138, 1143–44 (5th Cir. 1990); Eubanks v. FDIC, 977 F.2d 166, 170–71 (5th Cir. 1992) (holding that post-confirmation prosecution of non-bankruptcy causes of action not preserved under the confirmed plan was barred by *res judicata*).

142. *Spicer*, 647 F.3d at 553.

143. *Id.* at 553 (internal citations and quotations omitted) (emphases added).

time, recent statistics suggest a substantial decrease in the number of new bankruptcy cases, especially business cases. If this trend continues, it is likely to have a significant practical effect on bankruptcy practitioners. Yet, with continuing global and domestic banking and debt problems, scandals, and frauds, it is likely that the Bankruptcy Code (including, on an increasing basis, Chapter 15) will continue to be the mechanism of last resort for many borrowers and businesses as the last of the "extend and pretend" era forbearances comes to an end. In that respect, the present may well represent the proverbial calm before the storm. Fortunately, the positive precedent of 2011 and the continuing professionalism, user-friendliness, and expertise of our bankruptcy courts should make the job of the practitioners easier in order to better enable the practitioner to devote time to solving substantive problems.