SMU DEDMAN SCHOOL OF LAW

SMU Law Review

Volume 64 | Issue 1 | Article 5

January 2011

Bankruptcy

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Recommended Citation

Joseph J. Wielebinski & Davor Rukavina, *Bankruptcy*, 64 SMU L. REV. 49 (2011)
https://scholar.smu.edu/smulr/vol64/iss1/5

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Bankruptcy

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I. INTRODUCTION

A number of important bankruptcy opinions appeared in 2010 as bankruptcy courts continued to work through volumes of filings and difficult challenges posed by recent economic events and the structure of complex debt and equity obligations. Discussed below are various court opinions which the authors believe are significant, either for their legal holdings, their practical applications, or as guidance for practitioners that may encounter similar issues.

As it 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 in class actions and Chapter 15 cases and, in some respects, attempted to make administration of bankruptcy estates more flexible for bankruptcy courts. The U.S. Supreme Court offered significant guidance, primarily in the realm of consumer bankruptcies and Chapter 13 but with broader application to the general confirmation of bankruptcy plans and their effects. It seems to appear that the U.S. Supreme Court's opinions are at odds with some recent Fifth Circuit opinions apparently limiting the effects of plan confirmation—an interesting potential juxtaposition that practitioners will be able to use as they continue struggling with these Fifth Circuit opinions. Bankruptcy courts issued numerous opinions, many of them too fact-specific for inclusion in this article, although certain bankruptcy court opinions included in this Survey are of broader importance. Given the volume of recent real estate filings, and the perceived likelihood of a large number of real estate Chapter 11s in the near future, practitioners will find some guidance from these lower court opinions. Of particular interest is how the lower courts are analyzing the duties of a debtor-in-possession and the effect of these decisions on a Chapter 11 plan. Such issues are raised more often in Chapter 11 real estate cases where there are insider guarantees and large deficiency claims. Furthermore, several important opinions are currently on appeal and practitioners are encouraged to follow these cases closely to see how the Fifth Circuit will decide the issues.

II. AVOIDANCE ACTIONS

A. *In re* Condor Insurance Ltd.[1]

Condor Insurance Ltd. is an important jurisdictional opinion regarding Chapter 15 of the United States Bankruptcy Code (the "Code"). In this case, a liquidation proceeding was pending in the Federation of Saint Kitts and Nevis. The bankruptcy court recognized the case as a foreign main proceeding. The foreign representative then filed an adversary proceeding against a domestic company alleging the equivalent of a fraudulent transfer claim under Nevis law. The bankruptcy court dismissed the adversary proceeding for lack of subject matter jurisdiction.

The Fifth Circuit reversed.[2] Applying ordinary rules of statutory interpretation, the circuit noted that Chapter 15 specifically directs courts to "consider its international origin, and the need to promote an application of the chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions' in interpreting its provisions."[3] The court noted that prior to the adoption of the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency ("Model Law") (codified as Chapter 15 in the United States Code), U.S. courts were frequently more willing to assist foreign liquidation proceedings than foreign courts were to U.S. proceedings. Chapter 15 was partially adopted to ensure that foreign countries adopting the Model Law would provide judicial assistance to U.S. proceedings. Thus, the Model Law is an important "effort by the United States to harmonize international bankruptcy proceedings for the benefit of American businesses operating abroad."[4] Although not explicitly stated by the Fifth Circuit, the import of its opinion is that it would potentially prejudice U.S. proceedings to obtain assistance from foreign courts if the courts were without jurisdiction to lend assistance to foreign proceedings—striking at the very purpose of Chapter 15.

Chapter 15 provides that a bankruptcy court may grant "any appropriate relief" to the foreign representative, "except for relief available under sections 522, 544, 545, 547, 548, 550, and 724(a)."[5] While domestic avoidance actions are specifically excluded from the relief that may be granted, Chapter 15 does not exclude relief under foreign avoidance laws (however, relief under domestic avoidance statutes may be granted under Chapter 15 provisions inapplicable in this case). Therefore, applying ordinary statutory construction, and in light of the purpose of Chapter 15, the Fifth Circuit concluded as follows:

> [W]here there are enumerated exceptions 'additional exceptions are not to be implied, in the absence of a contrary legislative intent.'

1. Fogerty v. Petroquest Res. Inc. (*In re* Condor Ins. Ltd.), 601 F.3d 319 (5th Cir. 2010).
2. *Id.* at 329.
3. *Id.* at 321 (quoting 11 U.S.C. § 1508 (2006)).
4. *Id.* at 322.
5. *Id.* at 322–23 (quoting 11 U.S.C. § 1521(a)(7)).

> And the oft recited maxim *expressio unius est exclusio alterius* carries weight. The statute provides for 'any relief' and excepts only actions under sections 522, 544, 545, 547, 548, 550, and 724(a) of the Code and includes no other language suggesting that other relief might be excepted. While the statute denies the foreign representative the powers of avoidance created by the U.S. Code absent a filing under Chapter 7 or 11 of the Bankruptcy Code, it does not necessarily follow that Congress intended to deny the foreign representative powers of avoidance supplied by applicable foreign law. If Congress wished to bar all avoidance actions whatever their source, it could have stated so; it did not.[6]

While the court was mindful of potential forum shopping and choice of law issues, the facts in this case did not implicate these concerns (i.e. a foreign representative mixing and matching various provisions of domestic and foreign law, as opposed to using only the Code and its distribution scheme in exchange for its avoidance powers, the Fifth Circuit felt these considerations could be dealt with by the trial court). Furthermore, the circuit stated, "The foreign representatives gain no powers not contemplated by the laws of Nevis through filing suit in the United States and the distribution regime established by Nevis law is not threatened by the potential application of conflicting avoidance rules."[7]

Because Chapter 15 was enacted to facilitate international cooperation and judicial assistance, and because the foreign representative filed the adversary proceeding based on foreign avoidance statutes and not the Code's avoidance powers, the Fifth Circuit concluded that the bankruptcy court (through reference from the district court) had subject matter jurisdiction over the suit.[8] This opinion not only confirms the broad jurisdiction of the bankruptcy court but, importantly, preserves and furthers the purpose of Chapter 15. It would be peculiar if a foreign representative could not access Chapter 15 or the bankruptcy court to assert a right existing under foreign law (meaning he would not exploit the Code merely for its avoidance powers), yet U.S. trustees could seek similar assistance from foreign courts in domestic cases under the Code's avoidance powers. The principles of cooperation and *mutual* assistance at the heart of Chapter 15 would be jeopardized. By addressing not only the statute's language, but also its fundamental purpose—which itself is statutory—the Fifth Circuit should be commended for furthering Congress' intent, something the authors hope will continue as the court construes issues involving bankruptcy jurisdiction.

B. *In re* NE 40 Partners, L.P.[9]

In *NE 40 Partners, L.P.*, Judge Jeff Bohm of the U.S. Bankruptcy Court for the Southern District of Texas considered a Chapter 7 trustee's argu-

6. *Id.* at 324 (quoting Andrus v. Glover Const. Co., 446 U.S. 608, 616–17 (1980)).
7. *Id.* at 327.
8. *Id.* at 329.
9. *In re* NE 40 Partners, L.P., 440 B.R. 124 (Bankr. S.D. Tex. 2010).

ment that in pleading a fraudulent transfer cause of action, the trustees should be held to a lessened pleading standard because the trustee based the allegations on second-hand knowledge and the trustee, by definition, did not have personal knowledge of those allegations. The court rejected this argument.[10] Noting that Rule 9 of the Federal Rules of Civil Procedure requires a heightened pleading standard for a fraudulent transfer suit, and construing recent Supreme Court precedent on this issue and determining that the Fifth Circuit strictly applies Rule 9, the court concluded there is no relaxed standard for a Chapter 7 trustee.[11] The court instead encouraged Chapter 7 trustees to employ the tools provided to them, including Bankruptcy Rule 2004, to investigate underlying matters prior to filing a complaint.

Although the court's opinion is well reasoned and appears correct, it seems unlikely that the result (perhaps necessarily so) will promote the "just, speedy, and inexpensive determination of every case and proceeding" required by Bankruptcy Rule 1001.[12] A fraudulent transfer defendant, on the other hand, is entitled to detailed notice of allegations against him. The potential problem is that these defendants will use the opinion to transform an orderly motion to dismiss or a motion for more definite statement into a gatekeeper process involving several rounds of motion litigation causing multiple proceedings. Such opinion may require a trustee to devote estate resources for prelitigation discovery (such as under Bankruptcy Rule 2004) where the estate may have no funds to pay for these expenses.

III. AUTOMATICSTAY

A. *In re* Texas Rangers Baseball Partners[13]

Section IV of this article contains a detailed discussion of the *Texas Rangers* opinion as it affects Chapter 11 plans. This opinion is also briefly discussed in this Section for a secondary, but important point. The lenders of the debtor argued that under the prepetition loan documents, when the debtor went into default the lenders had a right to effectively remove the management of the debtor and replace it with management of their choosing. The court disagreed for several factual reasons and also because such an attempt postpetition would violate the automatic stay. The court held that "any effort on the part of Chase to enforce its contractual right to control either entity or Debtor would amount to a violation of the automatic stay of Code § 362(a)."[14] The authors of this article believe that postpetition attempts to remove management based on prepetition contract rights are infrequent. Nevertheless, given recent loan agreements and covenants under which borrowers seemingly grant everything

10. *Id.* at 129.
11. *Id.* at 127–29.
12. Fed. R. Bankr. P. 1001.
13. *In re* Tex. Rangers Baseball Partners, 434 B.R. 393 (Bankr. N.D. Tex. 2010).
14. *Id.* at 404.

to a lender upon default, this issue may be litigated again. In such an instance, the *Texas Rangers* opinion together with other reported precedent, provides support for the proposition that an automatic stay prohibits such postpetition change of control. Moreover, if a court grants relief from the stay and permits a lender to change the debtor's management, it appears that a court would more likely appoint a trustee because the independence and impartiality of a creditor-appointed management may well be questioned.

IV. CHAPTER 11 PLANS

A. *In re* Oceanaire Texas Restaurant Co., L.P.[15]

Oceanaire Texas Restaurant Co., L.P. is not a published opinion, but is included due to its unique set of facts and the important principle it teaches. In this case, Chief Judge Barbara Houser of the U.S. Bankruptcy Court for the Northern District of Texas denied confirmation of a 100% payment plan because the court found the debtor had not proposed the plan in good faith.[16] Specifically, the debtor filed its Chapter 11 petition to reject unprofitable leases and to restructure obligations to the bank for its upscale restaurants. The debtor proposed a plan with a 100% payout to unsecured creditors over a five year period:

> The [creditors] committee objected to confirmation of the plan for a variety of reasons, including . . . that, one, the plan was not proposed in good faith; two, the plan was not feasible; three because unsecured creditors were not receiving deferred cash payments having a present value equal to their allowed claims, the plan was not fair and equitable; and four, because a former equity holder of the parent debtor . . . was receiving property under the plan, the plan failed to satisfy the absolute priority rule . . . .[17]

The crux of the committee's objection was that while the plan nominally promised payment in full, such payment was risky and was made over time. Similarly, several interested bidders had approached the committee and indicated they were prepared to purchase the debtor's assets for an amount sufficient to pay all creditors in full immediately. One such bidder, Landry's Restaurants, Inc. ("Landry's"), offered enough cash to fully pay all priority, secured, and unsecured creditors, together with assumption of all leases and executory contracts, thereby saving all the restaurants and the jobs of employees. The debtor represented it would negotiate with Landry's in good faith, and if Landry's offer was more favorable than that of the former equity holder of its parent debtor, the debtor would then substitute Landry's offer into the plan. Landry's

15. Transcript of Telephonic Proceedings Before the Honorable Barbara Hauser, U.S. Chief Bankr. Judge, *In re* Oceanaire Tex. Rest. Co., L.P., No. 09-34262-bjh-11 (Bankr. N.D. Tex. Jan. 29, 2010).
16. *Id.* at 24.
17. *Id.* at 14.

submitted what the court deemed as a "clearly superior offer."[18] However, the debtor filed its plan with the offer of another bidder, Clarion Capital Partners, LLC ("*Clarion*"). The court denied confirmation, noting "the irony of the Court's conclusion that a plan that proposes a 100% distribution to unsecured creditors is not proposed in good faith" and acknowledging the court presided over many cases where plans proposing far less were confirmed.[19] While the debtor's plan was ostensibly a 100% payment plan, the court determined it was in fact a "thinly-veiled attempt to shield Clarion, an insider equity holder, from the economic reality of today's marketplace."[20]

Although the facts in *Oceanaire* are not frequently encountered—how often are there competing 100% plans and how often is a 100% plan proposed in bad faith?—this opinion stands for the proposition that a plan's merits and good faith are not viewed in a vacuum, but rather, a court may review and analyze readily available alternatives to the debtor to assess whether the debtor really proposed the plan in good faith. The case is also an important reminder that the management and professionals of a debtor-in-possession must act in the best interests of the estate, and that an immediate, guaranteed, full payment, along with preservation of the business and employees, is clearly better than a speculative, five year plan that primarily benefits equity. Yet the opinion is troubling because 11 U.S.C. § 1129 provides that a court "shall" confirm a plan if all the plan requirements are met; resorting to good faith and a comparison of alternatives for an otherwise accepted plan suggests a debtor's business judgment is susceptible, not only to questioning, but also to being superseded.[21] It is also interesting to compare this opinion to the *Texas Rangers* opinion discussed below where the issue was also a 100% plan.

B. *In re* Texas Rangers Baseball Partners[22]

Most practitioners are familiar with the *Texas Rangers* case, including the colorful nature of some participants, the critical timing issues, and the auction that ultimately led to a successful result. Along the way, however, Judge D. Michael Lynn of the U.S. Bankruptcy Court for the Northern District of Texas faced difficult questions of law regarding confirmation of the debtor's plan. Judge Lynn's discussion of the various confirmation requirements and equity's role in a confirmation setting are instructive because although the facts of *Texas Rangers* are rare, the legal principles governing the case are routinely faced by practitioners. Fortunately, through the efforts of various professionals and two bankruptcy judges, the Code was shown to be flexible enough to handle a case this complex and demanding.

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18. *Id.* at 17.
19. *Id.* at 24.
20. *Id.* at 19.
21. *See* 11 U.S.C. § 1129 (2006).
22. *In re* Tex. Rangers Baseball Partners, 434 B.R. 393 (Bankr. N.D. Tex. 2010).

In this case, the debtor guaranteed a portion of its ultimate parent's overall indebtedness. Prior to the petition date, the debtor secured a sale of its business to a buyer approved by Major League Baseball. That sale would pay all the *debtor*'s creditors in full and lead to a distribution to equity. While the debtor would pay its obligation to the lenders, the lenders argued there were other parties who would pay substantially more for the debtors' assets. This would lead to a greater distribution to equity, ultimately benefiting the lenders, the lenders could not benefit from an increase in value of the debtor's assets under the guaranty because the debtor's guarantee obligation was capped, but they could benefit by attaching and seizing the distributions to the equity holders, who were also obligors. The debtor filed its plan on the same date it filed its petition, which proposed to consummate the purchase to the approved buyer. The plan would have paid the guarantee obligation in full and all other unsecured claims. Thus, the debtor argued the lenders were unimpaired and not entitled to vote on the plan. The lenders argued, among other things, that they were impaired because, the plan did not leave their legal rights unaltered as required by § 1124 of the Code, although the plan might pay their claim in full. The loan documents gave the lenders the right to approve or reject, among other things, any proposed sale of the team. Because the plan operated in a way that took this right from the lenders, the lenders argued they were impaired and therefore entitled to vote on the plan.

The court also considered whether the debtor had a duty to maximize the value of its estate even though the current plan provided for 100% payment of all claims and a substantial return to equity—i.e. did the debtor have a duty to maximize a return to equity? Complicating the issue was the equity holders' consent to the plan (indeed, they effectively proposed the sale component to the plan), meaning that creditors were to be paid in full and the only parties potentially prejudiced by a failure to obtain the highest price for the team had consented to this failure.

The court first addressed the duty to maximize value. Reviewing cases generally applying this point, the court noted:

> In none of these cases did the court directly face the value maximization issue where the facts were that (1) the debtor was clearly solvent and paying creditors in full and (2) all the equity owners had consented to accept a transaction that provided to them less than their potential maximum recovery.[23]

The court also particularly noted that a fundamental purpose of the Code and Chapter 11 is to provide a mechanism for consensual restructuring of rights and obligations: "It is an underlying premise of the Code that parties should be allowed to structure their own resolutions in cases respecting how claims and interests will be satisfied from a debtor's es-

23. *Id.* at 400–01.

tate."[24] After all, taken in isolation, the equity holders were free to accept less than optimum treatment:

> Allowing a class to elect less than optimal treatment is sensible. A class—particularly one of equity interests—may have motives other than maximizing return. For example, a class of trade creditors or equity owners may elect to give up value to maintain business relationships or continue particular management in control of a debtor.[25]

Accordingly, under the facts of this case, where all creditors would be paid in full and equity holders had accepted the plan, the court concluded that the debtor did not have a duty to maximize value for its equity holders.[26] The court cautioned, however, that the equity holders are not necessarily free to accept a plan that does not maximize value for *their* creditors.[27]

With respect to the impairment issue, the court decided that the lenders were in fact impaired under the plan notwithstanding the full payment.[28] Describing unimpairment generally, the court noted that not being impaired is as "if a creditor receives under a plan everything to which the creditor would be entitled in a judgment entered immediately following the plan's effective date."[29] Here, the lenders had contract rights in addition to mere payment of a capped guarantee obligation. However, the court disagreed with the lenders that one of those rights included the right to approve or disapprove any proposed sale of the team. As held by the court, § 1124(1) is prospective because "section 1124(1) does not require that a plan provide for the cure of defaults—i.e., recreation of the situation as it was before default. Rather it requires that, as of the plan's effective date, an unimpaired creditor be able thereafter to exercise all its rights *vis-à-vis* its debtor."[30] Because a sale of the team would be effectuated prior to the effectiveness of the plan, the lenders could still be unimpaired as of such plan effectiveness and thereafter, even though rights were modified or suspended prior to plan effectiveness. As with any case involving contractual breach, the lenders would have a potential claim against the debtor or third parties, but this would not leave them impaired.

Additionally, the court noted that giving the lenders the right to approve or disapprove a sale of the team while a debtor is under the court's jurisdiction, is inconsistent with the Code and contrary to public policy:

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24. *Id.* at 401.
25. *Id.*
26. *Id.* at 402.
27. Of interest, the lenders filed involuntary petitions against the equity holders. Thus, those equity holders would be voting on the debtor's plan as alleged debtors. Given these facts, the court invoked § 303(f) of the Code and required the equity holders/alleged debtors act in a fiduciary capacity to their creditors similar to a trustee. *Id.* at 405.
28. *Id.*
29. *Id.* at 406.
30. *Id.* at 407 (citing Bustep Shelters of Lewisville, Inc. v. Classic Homes, Inc., 914 F.2d 810, 814–15 (6th Cir. 1990)).

> As a sale of the Rangers, whether under Code § 363 or under a plan, by Debtor acting as a debtor-in-possession is a transaction undertaken by Debtor in its role as a fiduciary, it would be inconsistent with the authority and responsibility conferred on that fiduciary by law to give effect to a contractual provision that would frustrate its performance of its fiduciary duties.[31]

Similarly, in the event the lenders exercised their contractual sale approval rights, the only way the debtors could potentially confirm a plan would be to "artificially" impair a class for voting purposes, which is also inconsistent with public policy when that class was otherwise left unimpaired. Thus, the court held that the lenders were not impaired because they were not permitted to exercise their sale approval rights during the pendency of the case, and impairment under § 1124(1) of the Code operates prospectively after effectiveness of the plan.[32] However, because the plan did not provide for the lender's full, prospective rights under the loan documents after plan effectiveness, the plan did in fact impair the lenders.

In summary, these are the important principles from the *Texas Rangers* case: (1) a debtor may not have a duty to maximize value of an estate if creditors are paid in full or equity, holders (and perhaps creditors) accept lesser treatment and (2) a creditor can be unimpaired even if its rights are modified during a case, so long as the creditor retains its legal rights after the effective date. While these important principles have broader application than just the *Texas Rangers* case, interesting questions remain. For example, creditors and equity holders voting on a plan may not know about a potential alternative that offers a higher return. They may still accept that plan, but may act differently if they knew of a better alternative. In this respect, *Texas Rangers* and *Oceanaire* seem at odds. On the other hand, so long as full disclosure is provided *and* the creditors or equity holders accept lesser treatment, why should they not be free to do so? With respect to impairment, what does it mean to have your rights preserved prospectively after a plan if during the case your rights were effectively and permanently lost? Is that not the height of form over substance? Judge Lynn notes, however, that a creditor in that position has a resulting claim against the debtor or third parties that may provide a sufficient safeguard.[33] Indeed, how can any creditor under today's loan document be unimpaired when filing a petition itself is often a breach, various loan ratios and bankruptcy litigation are further breaches, and historical non-monetary breaches cannot be cured? So it appears the question of impairment must be suspended during the pendency of a case for it to have meaning. Perhaps that is the ultimate lesson of *Texas Rangers*—the Code has sufficient flexibility to accommodate unusual debtors and cases and parties have sufficient rights and remedies to facilitate re-

31. *Id.* at 410.
32. *Id.* at 409–10.
33. *See id.* at 408.

organization, to effectuate the purposes of the Code, and to pay creditors, which are essentially what the process is all about.

C. *In re* Texas Wyoming Drilling, Inc.[34]

Chapter 11 practitioners are well aware of *United Operating*, in which the Fifth Circuit held that a postconfirmation entity lacks standing to prosecute causes of action not specifically and unequivocally preserved in a Chapter 11 plan.[35] In *Texas Wyoming Drilling, Inc.*, Judge D. Michael Lynn of the U.S. Bankruptcy Court for the Northern District of Texas considered this issue in a consolidated opinion regarding two separate cases and plans. The court held a categorical reservation of avoidance actions (without naming each defendant and describing each cause of action) is sufficient and satisfies *United Operating*'s requirements.[36] The court separately held in the opinion's second case that even though the confirmed plan failed to sufficiently retain the causes of action, the plan must be read with the disclosure statement, and read together, the debtor had adequately retained the causes of action.[37] Each opinion is addressed below.

1. *Categorical Preservation of Avoidance Actions*

At issue was a confirmed Chapter 11 plan; the court converted the case to Chapter 7 after confirmation and the effectiveness of that plan, in light of the debtor's defaults is addressed. After confirmation, but prior to conversion, the debtor initiated fraudulent transfer avoidance actions against multiple prepetition equity interest holders, alleging that the defendants received fraudulent transfers. After conversion, the trustee continued prosecuting the claims, and the defendants moved for summary judgment, arguing that the trustee lacked standing because the plan did not preserve the causes of action to the level of specificity required by *United Operating.* The plan did not name the defendants; rather, it contained a categorical reservation of claims provision that retained any and all avoidance actions (which the plan defined as including claims under § 548 of the Code), and vested the same in the postconfirmation reorganized debtor. The defendants argued that this language was not "specific and unequivocal" as required by *United Operating*, which the court found otherwise controlling.

The court noted that while *United Operating* sets forth the "specific and unequivocal" standard, the issue presented was "[w]hat does it mean for language to be specific and unequivocal?"[38] Although *United Operating* holds that a "blanket reservation of 'any and all claims' is insufficient,"

34. Spicer v. Laguna Madre Oil & Gas II, LLC (*In re* Tex. Wyoming Drilling, Inc.), 422 B.R. 612 (Bankr. N.D. Tex. 2010).
35. United Operating, L.L.C. v. Dynasty Oil & Gas, L.L.C., 540 F.3d 351, 355 (5th Cir. 2008).
36. *Tex. Wyoming*, 422 B.R. at 629.
37. *Id.* at 630–31.
38. *Id.* at 625.

this did not end the inquiry.[39] First, while *United Operating* recognized the "specific and unequivocal" standard, the Fifth Circuit did not require identification of a specific cause of action against a specific defendant. On the contrary, the Fifth Circuit cited its approval of non-binding case law where a categorical reservation of preference claims was found to be sufficient. "The Fifth Circuit Court of Appeals thus has not required a plan to identify specific individuals or entities as prospective defendants in order to preserve the claims; rather, as appropriate, claims may be preserved by category."[40] Here, the issue was avoidance actions—causes of action created by Congress benefitting creditors by enabling the debtor or trustee to avoid and recover prepetition transfers made at their expense. The court therefore doubted that the Fifth Circuit intended a broad application of *United Operating* that would prejudice the creditors by leading to a loss of valuable rights through an inadvertent "application of a '17th Century' test for pleadings."[41]

Second, given that the primary concern in *United Operating* was that creditors voting on a plan be given sufficient notice of intent to sue those creditors postconfirmation, the court analyzed whether such notice was provided to the defendants:

> The purpose of the specific and unequivocal language requirement is not to put potential defendants (at least those not voting on the plan) on notice of lawsuits that may be brought against them; rather, the purpose is to put creditors that are entitled to vote on notice that there may be assets in the form of potential lawsuits so that they may pass on the plan with sufficient knowledge of the assets that are available to pay the claims held by the creditors against the debtor. Consequently, the question of whether standing to pursue the TWD Claims post-confirmation has been preserved turns on whether the language in the TWD Plan was sufficient to put creditors on notice that TWD anticipated pursuing the TWD Claims after confirmation.[42]

Not only did the plan contain a categorical reservation of claims, but also the plan defined avoidance actions as including fraudulent transfer claims. The plan further set forth a mechanism where the reorganized debtor would transmit to defendants a letter agreement tolling limitations in order to provide additional time for potential negotiations and consensual resolution. Furthermore, the disclosure statement identified several defendants by name and categorically identified unnamed defendants. The disclosure statement also provided an estimate of potential fraudulent transfer claims and discussed potential barriers to recovery. Thus, creditors were sufficiently placed on notice that the reorganized debtor reserved the right to assert avoidance actions postconfirmation and the

39. *Id.*
40. *Id.* at 626–27.
41. *Id.* at 627 n.15.
42. *Id.* at 627–28 (internal citations omitted).

debtor would prosecute those actions with proceeds used towards funding the plan.

Therefore, because notice to creditors voting on a plan underpinned the Fifth Circuit's analysis in *United Operating*, and because the debtor clearly informed the creditors that it was preserving avoidance actions and vesting them in the reorganized debtor, the "specific and unequivocal" standard was met through the categorical reservation of claims. The court noted that the result might well be different if the causes of action in question were not avoidance actions.[43] But, because (1) nothing in *United Operating* required identification of a defendant by name and identifying the cause of action against that defendant, (2) *United Operating* confirmed that a categorical reservation of claims sufficed for avoidance actions but not other actions, and (3) creditors received sufficient notice, the court rejected the defendants' standing and jurisdictional argument (along with the defendants' judicial estoppel and *res judicata* arguments).[44]

This is an important opinion for several reasons. As Chapter 11 practitioners know, it has been difficult to properly interpret *United Operating*'s holding. It is unrealistic and unworkable to expect a debtor to investigate each and every cause of action while doing all the things required of a Chapter 11 debtor prior to formulating a plan, putting the entire case on hold and devoting substantial resources so that the debtor can provide the court with exhaustive detail on each potentially valuable cause of action. Conversely, merely naming each potential defendant and listing each hypothetical cause of action provides no more specificity than stating all claims against all potential defendants are preserved. The *Texas Wyoming* court did not attempt to set the outer boundaries of *United Operating* or set a formulistic approach to testing a retention of a claims provision, but rather it set forth a simple and workable rule: regardless of what *United Operating* requires for a non-bankruptcy claim, avoidance actions, which exist to benefit the very creditors who vote on a plan, may be retained categorically.[45] This holding not only honors the requirement and logic of *United Operating*, but it is a practical, efficient, and reasonable approach in light of the realities of Chapter 11 administration.

The Fifth Circuit granted a direct appeal of the court's opinion with oral arguments scheduled for April 2011. The result of that appeal will not only be the resolution of this important question, but will also undoubtedly provide further guidance on the proper application of the "specific and unequivocal" standard, which will benefit all practitioners. Practitioners are therefore encouraged to research the results of this direct appeal, and a summary thereof will almost certainly appear in next year's Survey.

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43. *See id.* at 629 n.17.
44. *Id.* at 631–35, 637.
45. *See id.* at 627.

2. Importance of Disclosure Statement

The *Texas Wyoming Drilling* opinion considered not only the categorical retention of avoidance actions under a plan, but also a separate Chapter 11 plan where the debtor asserted non-bankruptcy causes of action postconfirmation. Here, the individual Chapter 11 debtor sued her former attorneys postconfirmation under a variety of malpractice, breach of contract, and breach of duty of care causes of action under Texas law. The confirmed plan contained a categorical reservation of claims provision stating that "all real and personal property of the estate . . . including but not limited to all causes of action . . . and any avoidance actions . . . shall vest in [Ranzino-Renda]."[46] This was not so much a retention of claims provision as a revesting provision. Ultimately, the court concluded this was exactly the kind of blanket provision rejected by *United Operating*, and the plan standing alone was insufficient to preserve the underlying causes of action.[47]

However, this was not the end of the inquiry because the disclosure statement contained a detailed description of the causes of action against the attorneys:

> *Claims Against Sullivan, Parker & Cook, L.L.C., Jeffrey Cook, and J. Todd Key (together the "SPC Defendants")*. The Debtor's claims and causes of action against the SPC Defendants arise out of the SPC Defendants acts and omissions as Debtor's attorney . . . and include but are not limited to claims of DTPA, negligence, breach of contract, misrepresentation and fraud. The Debtor seeks claims for both actual and consequential damages, reasonable and necessary attorney's fees, exemplary damages, and prejudgment and postjudgment interest. . . . Under the Plan, the Debtor retains the right to prosecute any of the foregoing claims until such time as the Debtor determines in her reasonable business judgment that such claims are burdensome to the Reorganized Debtor or are of inconsequential value and benefit to the Reorganized Debtor.[48]

This was such a detailed description that had it been in the plan, there would be no question this language satisfied *United Operating*. The question before the court was whether the presence of this language in the disclosure statement saved the plan from its failure to comply with *United Operating*.

The court noted that "[c]ontract rules of interpretation apply to bankruptcy plans."[49] A contract should be construed as to effectuate the intent of the parties. Furthermore, to the extent they pertain to the same transaction, contemporaneous documents may be construed together in assessing those parties' intent. "Thus, in a bankruptcy case, a plan and disclosure statement may be considered together to determine the intent

46. *Id.* at 620.
47. *Id.* at 621.
48. *Id.*
49. *Id.* at 629.

of the parties."[50] The court noted that under Bankruptcy Rule 3017, creditors may not even receive the plan, instead just receiving the disclosure statement and plan summary. Finally, the court cited various other opinions where courts had construed a plan and a disclosure statement together. Thus, because: (1) the disclosure statement sufficiently described and explained the vesting of assets provision, (2) the two documents may be construed together, and (3) the disclosure statement evidences the parties' intent, the court concluded that the disclosure statement supplemented or explained the plan and satisfied *United Operating*'s "specific and unequivocal" standard.[51]

While this holding is of significance for its conclusion and for the proposition that a disclosure statement and plan may be read and applied together, it remains to be seen whether this view will be accepted. For one thing, it is the plan, not the disclosure statement, that is the operative document. While the court correctly analyzed contractual interpretation rules, it may be argued under those same rules, that a disclosure statement is an extraneous document that the parol evidence rule excludes from consideration. Furthermore, *United Operating* specifically addresses the sufficiency of a *plan*'s language to retain claims language. A strict read of *United Operating* could appear to compel a different result. At the same time, because *United Operating* is rooted in the notice requirement and the disclosure statement in this case clearly and unequivocally evidenced the debtor's intention to prosecute the claims postconfirmation, reference to the disclosure statement (or for that matter other pleadings and testimony) not only makes sense, but also comports with the spirit and purpose of the principles underlying the *United Operating* opinion.

D. *In re* Good[52]

Good is discussed below in greater detail as it applies to judicial estoppel. However, it also contains an important holding for purposes of Chapter 11: a secured claim is valued as of the confirmation date of a plan and not as of the plan's effective date, which may be much later. Here, the debtor's business suffered and its assets lost value after confirmation. The debtor therefore objected to a secured claim, arguing the § 506(a) secured portion was only about half the amount of the claim, even though the debtor represented at confirmation that it was oversecured. The creditor urged the court to value the claim as of the effective date of the plan, but the court declined to do so. The court noted the absence of any precedent supporting the debtor's position and the difficulty, if not impossibility, of assessing feasibility based on a date that may not occur until much later in time. Conversely, while a debtor faces the potentially

50. *Id.*
51. *Id.* at 630–31.
52. *In re* Good, 428 B.R. 235 (Bankr. E.D. Tex. 2010).

impossible task of proving feasibility, valuing a claim as of the effective date may provide a windfall to a debtor:

> Allowing a debtor to wait several months after confirmation to define the contractual effective date of the plan, and then set that date so that its secured creditors would bear the brunt of any post-confirmation depreciation, would violate 'the equitable nature of bankruptcy in seeking a balance between debtors and creditors. . . .'"[53]

This is particularly true because the debtor could manipulate the process by removing a deficiency claim and thus force a potential no vote in the unsecured class, while later asserting a claim objection that would lead to a potentially large unsecured claim.

V. CHAPTER 13

A. *Hamilton v. Lanning*[54]

In this Chapter 13 case, the U.S. Supreme Court addressed the requirement that a Chapter 13 debtor devote "projected disposable income" to his plan.[55] Specifically, the Court addressed whether the "mechanical approach" applies (which looks at monthly income multiplied by the number of plan months and then determines the disposable portion) or whether the "forward-looking approach" applies (which looks at reasonably foreseeable changes in the debtor's income or expenses).[56] The Court held the forward-looking approach applies, meaning a court may take anticipated future changes into account.[57] Specifically, in this case the debtor received a one-time buyout from her employer that greatly inflated her average prepetition income. The Chapter 13 trustee argued that this amount must be used to calculate disposable income, even though the debtor's real, postpetition income was substantially less. The Court disagreed with the trustee's proposed inflexible approach and held that, at least in exceptional cases or cases where future changes to income or expenses were known or virtually certain, the bankruptcy court may look past the strict six month look-back period provided by the Code.

The Court noted the ordinary meaning of the word "projected" does not mean mathematical application of prior actual results, but contemplates future anticipated changes. The Court looked at the application of similar statutes and also at specific Code provisions and other statutes where Congress required a straight mathematical approach. The Court confirmed the oft-quoted maxim that when Congress amends the bankruptcy laws, it does not write on a clean state: "Pre-BAPCPA bankruptcy practice is telling because we will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended

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53. *Id.* at 247 (quoting Fin. Sec. Assurance, Inc. v. T-H New Orleans, L.P., 116 F.3d 790, 798 (5th Cir. 1997)).
54. Hamilton v. Lanning, 130 S. Ct. 2464 (2010).
55. *Id.* at 2467.
56. *Id.*
57. *Id.*

such a departure."[58] The Court also noted the potential for prejudice to creditors and a windfall to debtors in the event that the debtor's postconfirmation income is projected to materially increase.

What is perhaps most interesting is the Court's analysis of harm to a debtor under the mechanical approach where the debtor in a case like this could not confirm a plan. Although the Court avoids platitudes concerning a debtor's ability to rehabilitate and the equitable nature of bankruptcy, the Court addresses and rejects various alternatives proposed by the trustee. First, the Court found that delaying a filing to allow the six month look-back period to move past an anomalous income is not often a viable option for a debtor and delay itself may be a factor in assessing a potential argument that the case was filed in bad faith. Next, the Court rejected the notion that the bankruptcy court can use § 101(10A)(A)(ii) of the Code to select a more representative six-month period because if the Code required use of the mechanical approach, this strategy would undermine that requirement. Third, the Court rejected the specious argument that the debtor could file a case, dismiss it, and simply refile it when the six-month period has passed. Fourth, the Court rejected the suggestion that a debtor could file a Chapter 7 case because the debtor, in such an event, would lose the benefits of Chapter 13 and would be subject to dismissal based on a presumption of abuse.

Thus, the Court effectively—in many instances without saying it—confirmed many bedrock principles of bankruptcy: (1) when bankruptcy laws are amended, courts may look to prior practice unless Congress indicates otherwise; (2) a debtor should have readily available access to the protections of bankruptcy; (3) the debtor should have the ability to reasonably select the chapter under which he files; (4) the debtor should not file bankruptcy merely to take advantage of the automatic stay; and (5) interpreting the Code should be done in a manner such that a term in one provision of the Code has the same meaning as in another, so that no provision of the Code should be interpreted as to render another provision meaningless because the Code is one integrated statutory scheme. Most importantly, given its significance and the fact a conservative court issued the opinion, the Court looked past the literal dictate of the statute to avoid an inequitable result and to give effect to the obvious intentions of Congress.

While this opinion lacks Chapter 11 application other than the general principles it applies, it will affect individual debtor Chapter 11 plans and situations where an integrated, holistic reading of the Code (giving purpose and meaning to the policy and principles behind it) is required to avoid an absurd result or a result that would clash with access to bankruptcy protection and the reasonable ability to attempt reorganization.

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58. *Id.* at 2473 (internal quotation omitted).

B. *IN RE* JACOBSEN[59]

Jacobsen deals with a Chapter 13 debtor's ability to dismiss the case and the bankruptcy court's ability to convert it to Chapter 7 in light of the U.S. Supreme Court's 2007 opinion in *Marrama v. Citizens Bank of Massachusetts*. In that opinion, the Court held that a Chapter 7 debtor does not have an absolute right to convert a case to Chapter 13, despite statutory language seemingly providing for the same.[60] In *Jacobsen*, the Fifth Circuit similarly concluded that a Chapter 13 debtor does not have an absolute right to dismiss his case.[61]

Here, the Chapter 13 debtor failed to schedule valuable property and misscheduled various other property and debt. Among other things, the debtor purchased real property in his spouse's name on the eve of bankruptcy and deeded other property to her, while still living with her, and failed to disclose multiple other properties titled in his wife's name that he managed. The schedules of assets and liabilities and statements of financial affairs further contained multiple other serious omissions. After the Chapter 13 trustee moved to convert the case, the debtor filed a motion to dismiss. The bankruptcy court ordered the case converted after an evidentiary hearing and denied the debtor's motion to dismiss. The issue before the Fifth Circuit was whether the debtor had an absolute right to dismiss his case or whether the bankruptcy court could convert the case in light of the debtor's bad faith. The court noted that lower courts within the Fifth Circuit were split on the issue.

Reviewing extensive precedent, and relying on the Court's opinion in *Marrama*, the court concluded that the debtor did not have an absolute right to dismiss: "Following the Supreme Court's decision in *Marrama*, we hold that a bankruptcy court has the discretion to grant a pending motion to convert for cause under § 1307(c) where the debtor has acted in bad faith or abused the bankruptcy process and requested dismissal under § 1307(b) in response to the motion to convert."[62] The Fifth Circuit apparently adopted the bankruptcy court's logic—logic with broader implications than just this case: "[B]ankruptcy courts have broad authority to take any action that is necessary or appropriate to prevent an abuse of process under § 105(a) of the Code, and that they would have such power even in the absence of § 105(a) due to the inherent power of every federal court to sanction abusive litigation practices."[63] The Fifth Circuit, however, was cautious to explain that its opinion should not be read as providing authority that a debtor can be forced to stay in Chapter 13 against his will. The court's issue was forced conversion to Chapter 7, not forced continuation of a Chapter 13 case.

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59. Jacobsen v. Moser (*In re* Jacobsen), 609 F.3d 647 (5th Cir. 2010).
60. *See generally* Marrama v. Citizens Bank of Mass., 549 U.S. 365 (2007).
61. *Jacobsen*, 609 F.3d at 649.
62. *Id.* at 660.
63. *Id.* at 661 (internal citations and quotations omitted).

With respect to the type of conduct that warrants denying a Chapter 13 debtor's motion to dismiss, the court did not set forth a bright line rule. Rather, it borrowed from the Supreme Court's opinion finding the underlying conduct should be "atypical" and that bad faith occurs only in "extraordinary cases."[64] A debtor attempting to conceal estate property and misleading his creditors with erroneous schedules "is clearly among the class of atypical debtors subject to the limited exception to § 1307(b)."[65] Thus, the bankruptcy court had discretion to deny the debtor's motion to dismiss and the exercise of that discretion was supported by the evidentiary record.

This case leads to an important lesson for those advising Chapter 13 debtors—if you conceal assets, mislead creditors, engage in bad faith (and a whole host of other actions or omissions that would rise to the level of bad faith and abuse of process), your case may be converted to Chapter 7 and you will have a trustee to deal with, not to mention a potential denial of a Chapter 7 discharge.

VI. DISCHARGE

A. *United Student Aid Funds, Inc. v. Espinosa*[66]

In this unanimous opinion, the U.S. Supreme Court refused to set aside an order confirming a Chapter 13 plan discharging a student loan debt without compliance with the required adversary proceeding and without making a finding of "undue hardship."[67] Here, the creditor received notice of the plan yet failed to object to confirmation of the plan and failed to timely appeal the order confirming the plan. The Court reaffirmed many bedrock principles governing the confirmation of a plan and the effects of that confirmation in the process—principles that apply to Chapter 13 plans as well as plans under the Code's other chapters.

The Court addressed whether the order was "void" under Rule 60(b)(4) because of failure to comply with the rules and failure to find "undue hardship." The Court found that the order confirming a plan is a final judgment. Noting the strong interest of finality under a confirmed plan for the benefit of the debtor and all the creditors, the Court noted that whether a judgment is void is narrowly reviewed, and only for certain limited reasons—the most common being fundamental due process or lack of jurisdiction. "A judgment is not void . . . 'simply because it is or may have been erroneous.'"[68] Similarly, a Rule 60(b)(4) motion is "not a substitute for a timely appeal."[69] Here, the requirement for finding "undue hardship" and the requirement to file an adversary proceeding were not jurisdictional. Moreover, the failure to serve the creditor with a sum-

64. *Id.* at 662 (quoting *Marrama*, 549 U.S. 365 at n.11).
65. *Id.* at 663.
66. United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367 (2010).
67. *Id.* at 1372.
68. *Id.* at 1377 (quoting Hault v. Hault, 57 F.3d 1, 6 (1st Cir. 1995)).
69. *Id.*

mons and complaint may have deprived the creditor of a procedural rule, but it did not deprive the creditors of fundamental due process because the creditor was served with the plan: "United received *actual* notice of the filing and contents of Espinosa's plan. This more than satisfied United's due process rights."[70] The Court additionally confirmed that the creditor submitted itself to the jurisdiction of the bankruptcy court by filing a proof of claim in the bankruptcy case. Having submitted to the bankruptcy court's jurisdiction and having actual notice of the plan, "Rule 60(b)(4) does not provide a license for litigants to sleep on their rights."[71]

This is not an important opinion that sets forth a new rule of law, interprets a new statute, or answers a previously ambiguous issue. Rather, it is important because it confirms the principles discussed above, including: (1) the finality of bankruptcy plans despite clear legal error, (2) the need to object in bankruptcy to preserve rights, (3) the importance of *actual* notice in bankruptcy as opposed to formalistic notice, (4) the bankruptcy court's jurisdiction, and (5) the submission of one's self to that jurisdiction. These are principles that bankruptcy practitioners know well and have relied on for many years. Yet it seems the Fifth Circuit has in some respects curtailed some of these principles in, for example, its recent opinions on equitable mootness (which is admittedly a different issue) and claim retention under a plan. This is why the Court's opinion in *Espinosa* is important—to remind various lower courts that the fundamental principles governing confirmed plans remain alive and well.

At the same time, the Court cautioned that bankruptcy courts should deny confirmation of a plan that obviously violates the Code even if the creditor fails to object to the plan. As stated by the Court, "the Code makes plain that bankruptcy courts have the authority—indeed, the obligation—to direct a debtor to conform his plan to the requirements of §§ 1328(a)(2) and 523(a)(8)."[72] Thus, "the bankruptcy court must make an independent determination of undue hardship before a plan is confirmed, even if the creditor fails to object or appear in the adversary proceeding."[73] This is also the lesson of *Espinosa*: bankruptcy courts have an independent duty to deny confirmation of a plan where it obviously violates the Code. This is a duty that various bankruptcy courts have addressed differently with differing degrees of scrutiny. After *Espinosa*, one may find bankruptcy courts applying greater scrutiny to plans. With courts being as busy as they are, however, if a creditor does not raise the issue, it is difficult to imagine that bankruptcy courts will scour every plan proposed or confirmed for legal error.

Another issue is whether a debtor's lawyer should ensure compliance with the Code—at least as to the more pertinent provisions of the

70. *Id.* at 1378.
71. *Id.* at 1380.
72. *Id.* at 1381.
73. *Id.*

Code—not only pursuant to his duties to the court and the estate, but also to the bankruptcy system as a whole, at least until the Supreme Court or Congress changes the present practice; all due to a perceived intentional manipulation of the plan process by debtor's counsel as fore-showed in *Espinosa's* comment that Congress is free to correct any perceived abuse of the plan system.

B. *In re* Moseman[74]

Moseman is a Chapter 7 case involving a § 727 discharge objection. Chief Judge Brenda Rhoades of the U.S. Bankruptcy Court for the Eastern District of Texas rejected a creditor's discharge objection and granted the debtor a discharge. Most of the court's opinion is fact-based. However, one portion of the opinion merits attention for its potentially broader application and for an apparent change from prior practice. Namely, whether prepetition placement of a non-exempt asset into an exempt asset on the eve of bankruptcy is grounds for a denial of discharge under § 27(a) of the Code.

Here, the debtor owned two houses prepetition. The debtor and his wife lived in one house for more than ten years, designating it as their homestead. The debtor had no equity in this house. With respect to the debtor's second house, the debtor used it as a rental house or as a home for his parents. The debtor had substantial equity in the second house. On the eve of bankruptcy, the debtor and his wife moved into the second house and claimed the house as exempt. The creditor sought to block the debtor's discharge because the taking of what was otherwise non-exempt property and placing it outside the creditors reach was the transfer of the debtor's property with the intent to hinder and delay creditors. The court ruled against the creditor finding no wrongful intent and otherwise rejecting the creditor's factual allegations. However, the court went on to address the debtor's argument that the transfer of the house was not a "transfer" within the meaning of § 727(a) of the Code.

The creditor based its argument on the Fifth Circuit's 1983 opinion in *Reed*, which held that "a debtor who converts nonexempt assets to an exempt homestead immediately before bankruptcy, with intent to defraud his creditors, must be denied a discharge."[75] Judge Rhoades distinguished this case because in *Reed*, the debtor actually disposed of and sold the asset, placing the proceeds into his homestead. The debtor here simply moved into a home he already owned, and did not dispose of, sell, or "transfer" anything. The creditor argued, however, that a homestead was a property right that could be transferred. The court disagreed as a matter of law, basing its holding on the recent Fifth Circuit opinion in *Rogers*, which concluded that in the context of § 522 of the Code, a home-

74. TSCA-234 Ltd. P'ship v. Moseman (*In re* Moseman), 436 B.R. 398 (Bankr. E.D. Tex. 2010).

75. First Tex. Sav. & Loan Assoc. Inc. v. Reed (*In re* Reed), 700 F.2d 986, 988 (5th Cir. 1983).

stead right was not an "interest" the debtor acquired when she moved into her home. Construing and applying *Rogers*, the court held as follows:

> The Fifth Circuit held in *Rogers* that a 'homestead interest' is not the sort of vested economic interest that can be acquired by a debtor. One has 'interests' in the property itself, not in the exemption that protects those interests. The homestead interest simply gives protective legal security to those vested economic interests in property that were acquired by the debtor before the filing of the petition. Likewise, in the bankruptcy context, the homestead exemption and the property interest impressed with that exemption are discrete concepts: the former is the debtor's legal right to exempt certain property interests from the bankruptcy estate, the latter is the debtor's vested economic interests in the property itself.[76]

Accordingly, because the homestead was not an "interest" under the Code, the debtor had not transferred a debtor interest prior to the petition date as required by § 727(a) of the Code.

While the *Moseman* opinion may be a natural consequence of the Fifth Circuit's *Rogers* opinion, it remains to be seen whether *Moseman* will have an impact on pre-bankruptcy planning. Because no underlying asset was disposed of to a third party, *Moseman* may have little real world application. On the other hand, *Moseman* stands for the proposition that an exemption is not an "interest" for purposes of § 727(a) of the Code. Because a debtor may have an exemption in many types of assets other than just a homestead and these exemptions may vary based on applicable state law, whether federal law applies, and one's marital status, the holding of *Moseman* may be used to support pre-bankruptcy planning and the placing of non-exempt assets into exempt ones.

VII. CLASS ACTIONS

A. *In re* Wilborn[77]

In *Wilborn*, the Fifth Circuit considered whether a bankruptcy court has authority to certify a class for class action purposes. The debtor sought to certify a class consisting of individuals who had filed Chapter 13 petitions in the U.S. Bankruptcy Court for the Southern District of Texas in order to sue a bank for allegedly charging undisclosed fees postpetition. The bankruptcy court certified the class and the Fifth Circuit permitted a direct, interlocutory appeal.

The issue before the Fifth Circuit was the bankruptcy court's jurisdiction. Given that each class member was a debtor under Chapter 13, there was no question that bankruptcy jurisdiction under 28 U.S.C. § 1334 existed. The precise question was whether a bankruptcy court could certify a class when members of that class filed petitions before different bank-

76. *Moseman*, 436 B.R. at 408 (internal quotations and citations omitted).
77. Wilborn v. Wells Fargo Bank (*In re* Wilborn), 609 F.3d 748 (5th Cir. 2010).

ruptcy courts, albeit in the same district. While the court recognized that reported opinions disagreed on this issue and multiple other courts had concluded that a bankruptcy court may not certify a class of debtors, it disagreed with the bankruptcy court and held that a bankruptcy court does have the power to certify a class of debtors. The circuit court rooted its holding in the fact that Congress provided as much in Bankruptcy Rule 7023:

> Although a federal rule may not extend a court's jurisdiction, its intended purpose should be upheld so long as it otherwise offends no substantive rights. We see no such result here. On the contrary, if bankruptcy court jurisdiction is not permitted over a class action of debtors, Rule 7023 is virtually read out of the rules.[78]

Although the court held that the bankruptcy court had jurisdiction to certify a class of debtors, it reversed its certification in this case because the elements for class certification were not met.

While limited in its practical application, given both the limited instances of bankruptcy class actions and the requirements of Rule 23, this opinion recognizes the breadth of bankruptcy court jurisdiction and of such court's ability to exercise the powers referred to it by the district court. It is important to note, however, that the issue was whether a bankruptcy court could certify a class where the underlying cause of action concerned rights under the Bankruptcy Code and the Bankruptcy Rules—the Fifth Circuit's opinion should not be read so broadly as to suggest a bankruptcy court may certify a class involving non-debtors or non-bankruptcy rights.

VIII. JUDICIAL ESTOPPEL

A. *Reed v. City of Arlington*[79]

This is one of the most important Fifth Circuit bankruptcy opinions dealing with judicial estoppel because the court judicially estopped the Chapter 7 trustee rather than the debtor for his failure to schedule a valuable cause of action.[80]

The debtor in this case, a former firefighter in Arlington, Texas, filed suit against the City of Arlington (the "City") for violation of the Family Medical Leave Act and obtained a district court judgment in excess of $1 million. After the City appealed the judgment to the Fifth Circuit, the debtor and his wife filed a Chapter 7 bankruptcy case but failed to include the pending judgment in their bankruptcy schedules and statements. The debtor also failed to disclose other non-exempt property interests and assets and the "no-asset" bankruptcy case was closed by the trustee with the debtor having secured a discharge.

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78. *Id.* at 754 (internal citations omitted).
79. Reed v. City of Arlington, 620 F.3d 477 (5th Cir. 2010).
80. *Id.* at 479.

After the Fifth Circuit affirmed the district court judgment, settlement discussions ensued and the debtor disclosed the prior bankruptcy to his attorney for the first time. The trustee was notified and the Chapter 7 case was reopened. The trustee obtained an order from the district court substituting herself for the debtor in the litigation even though the district court was divested of jurisdiction by the appeal. The City filed a supplement to its petition for rehearing with the Fifth Circuit seeking a take-nothing judgment against the debtor on the theory the debtor was judicially estopped from collecting due to his failure to schedule the judgment in his bankruptcy case. The Fifth Circuit remanded the case to the district court for a ruling on the judicial estoppel claim. While the district court found the debtor was judicially estopped from collecting the judgment, the district court found the trustee was not similarly estopped.

Chief Judge Edith Jones began her analysis by noting that "[j]udicial estoppel is a doctrine that protects the integrity of court proceedings by preventing a party from asserting a claim in a legal proceeding that is inconsistent with a claim taken by that party in a previous proceeding."[81] The court next noted that although the trustee had not taken inconsistent positions in the litigation (as is required for judicial estoppel), "she succeeds to the debtor's claim with all its attributes, including the potential for judicial estoppel."[82] In effect, the court concluded the trustee had stepped into the debtor's shoes. The Fifth Circuit felt that creditors were not disadvantaged by the judicial estoppel because few creditors filed claims and there were administrative claims to be paid first (a seemingly unsupported and illogical argument because administrative creditors are creditors), and it believed even the defendant, i.e. the City, may have been victimized by the failure to disclose the claim (apparently without evidence supporting this belief). Finally, the Fifth Circuit noted the debtor obtained a discharge and was able to get "rid of his creditors."[83] Apparently, permitting the trustee to recover would reward this behavior, although the Fifth Circuit, like the district court, could have simply applied judicial estoppel to any debtor recovery under § 726 of the Code.

Thus, the Fifth Circuit applied judicial estoppel to both the trustee and the debtor—something that appears unprecedented. Among other things, if the trustee did nothing wrong, the court could have limited judicial estoppel to ensure that the wrongdoer, i.e. the debtor, would not benefit; but the court speculated that creditors would not be harmed, even though facially the facts seem otherwise. The court's analysis also failed to take into account its prior opinion in *Grotjohn* where it concluded that a debtor had no ability to divest the Chapter 7 estate of intangible personal property.[84] Therefore, *Reed* may represent a dangerous extension

81. *Id.* at 481 (internal quotation omitted).
82. *Id.* at 482.
83. *Id.* at 483.
84. Reed v. Rabe (*In re* Grotjohn), 289 Fed. Appx. 702 (5th Cir. 2008). In an ironic twist, the *Grotjohn* Chapter 7 case (at the lower court level) concerned the same trustee successfully seeking to judicially estop the debtor from exempting a lawsuit he failed to

of judicial estoppel as an offensive weapon that enables a wrongdoer, in this case the City, to escape liability while harming innocent creditors even though a trustee or other fiduciary did nothing wrong. On the other hand, judicial estoppel exists to protect the integrity of the *courts* and here the debtor manipulated the courts on multiple fronts. As a doctrine to punish wrongdoing does not exist, perhaps the innocence or guilt of the trustee should not matter. Yet, bankruptcy courts, being courts of equity appear to have ample safeguards to ensure their vindication and to prevent benefitting a wrongdoer, without prejudicing innocent creditors or rewarding the other wrongdoer (for example, judicial estoppel and a host of Title 18 violations can be applied solely against the debtor).

On February 22, 2011, the circuit granted *en banc* review of *Reed* with arguments scheduled for May 2011. The authors encourage any reader of this Survey to research the results of this review, although a summary of that review will certainly appear in next year's Survey.

B. *In re* Good[85]

Good concerned a Chapter 11 debtor who objected to a secured creditor's claim after the confirmation of the plan, arguing the collateral value was less than the stated amount of the secured claim. Although the procedural background is complicated, the confirmed plan allowed the secured creditor's claim, but the debtor repeatedly represented that the secured creditor was oversecured. Thus the court entered an order providing for the contract rate of interest to be paid to the secured creditor under the plan because the creditor was oversecured. After the effectiveness of the plan, the debtor objected to the secured claim arguing that the collateral value was approximately half the amount of the claim. The creditor sought summary judgment, arguing the plan and the confirmation order constituted *res judicata*, and the debtor was judicially estopped from seeking to value the secured claim at less than the full claim amount.

Chief Judge Rhoades of the U.S. Bankruptcy Court for the Eastern District of Texas agreed with the creditor and denied the claim objection. First, the court held the confirmation date, and not the plan effective date, is the appropriate date for valuing the claim. This is due to a court's need to know the value at the time for confirmation purposes, and a contractual plan effective date may happen much later than confirmation of the plan or expiration of the appeal period. Next, the court held that it necessarily valued the claim as part of the confirmation process, along with entry of the confirmation order and subsequent orders on the plan. Finally, applying judicial estoppel, the court found that:

> LCI's arguments in support of its present objection directly contradict the arguments and evidence presented at confirmation. The

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schedule. In *Reed*, the same doctrine and logic was used to estop the trustee, even though she did nothing wrong.

85. *In re* Good, 428 B.R. 235 (Bankr. E.D. Tex. 2010).

Court relied on RMR's oversecured status as of the statutory effective date in confirming LCI's plan. LCI's plan would not have been feasible if the 'effective date' upon which RMR's claim was to be valued was some indeterminate date in the future.[86]

Moreover, the court noted that if the creditor was undersecured, it would have had a deficiency claim entitling it to vote on the plan.[87] This would enable the creditor to veto the unsecured class, and the debtor would have to comply with the cramdown requirements to obtain confirmation. Accordingly, there was a representation accepted by the court, and the debtor changed its position to the detriment of the creditor. The court therefore judicially estopped the debtor from challenging the value of the secured claim.[88]

IX. JURISDICTION

A. *In re* Condor Insurance Ltd.[89]

Condor Insurance Ltd. was previously discussed at length for its importance to avoidance actions. It is also included in this Section because of its holding that a bankruptcy court has jurisdiction under foreign law to consider avoidance actions brought by a foreign representative in a Chapter 15 proceeding. The Fifth Circuit noted in the process that Chapter 15 specifically directs courts to "'consider its international origin, and the need to promote an application of the chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions' in interpreting its provisions."[90] Chapter 15 was adopted in part to ensure foreign countries also adopting the Model Law provided judicial assistance to U.S. proceedings. Although Chapter 15 provides that a foreign representative may not resort to the Bankruptcy Code's avoidance action provisions, the circuit read the jurisdictional bases of Chapter 15 broadly along with its important purposes for international insolvency cases, and concluded the exception to jurisdiction should be read narrowly. Thus, by specifically excluding avoidance claims under the Bankruptcy Code but not specifically excluding similar claims arising under foreign law, the circuit held Congress did not intend to limit the bankruptcy court's jurisdiction and prohibited consideration of avoidance actions under foreign law.

B. *In re* Wilborn[91]

As discussed in Section VII.A, the Fifth Circuit in *Wilborn* held that a bankruptcy court has jurisdiction to certify a class action, at least when

86. *Id.* at 246.
87. *Id.*
88. *Id.* at 247.
89. Fogerty v. Petroquest Res. Inc. (*In re* Condor Ins. Ltd.), 601 F.3d 319 (5th Cir. 2010).
90. *Id.* at 321 (quoting 11 U.S.C. § 1508 (2006)).
91. Wilborn v. Wells Fargo Bank (*In re* Wilborn), 609 F.3d 748 (5th Cir. 2010).

the underlying causes of action involve bankruptcy rights and statutes over which the bankruptcy court exercises core jurisdiction.[92] Furthermore, the court held the bankruptcy court may certify a class even though the members of that class filed bankruptcy petitions before different bankruptcy courts.[93] The Fifth Circuit rooted its holding in the language found in Bankruptcy Rule 7023:

> Although a federal rule may not extend a court's jurisdiction, its intended purpose should be upheld so long as it otherwise offends no substantive rights. We see no such result here. On the contrary, if bankruptcy court jurisdiction is not permitted over a class action of debtors, Rule 7023 is virtually read out of the rules.[94]

X. PROFESSIONALS

A. *Milavetz, Gallop & Milavetz, P.A. v. United States*[95]

In this opinion, the U.S. Supreme Court put to rest the issue of whether attorneys are "debt relief agencies" under the 2005 Code amendments and whether such a rule is constitutional. The Court held that attorneys are debt relief agencies within the statute and the statute applied as such is constitutional.[96]

A debt relief agency is defined as "any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration."[97] As explained by the Court: "By definition, 'bankruptcy assistance' includes several services commonly performed by attorneys. Indeed, some forms of bankruptcy assistance, including the 'provi[sion of] legal representation with respect to a case or proceeding,' may be provided only by attorneys."[98] The Court therefore easily concluded that attorneys fall within the definition, rejecting arguments to the contrary.[99] Next, the Court considered whether the statute was constitutional as applied to attorneys. This issue came down to whether the statute was read broadly or narrowly—in prohibiting an attorney from advising a debtor "to incur more debt 'in contemplation of' filing for bankruptcy," what is the proper scope of the phrase "contemplation of bankruptcy?"[100] The attorney, reading the statute broadly, argued this provision prohibits any advice to incur debt when one is thinking he might have to file bankruptcy. The Court disagreed, noting that "in contemplation of bankruptcy" is a term of art.[101] Reviewing the common definition, the location of the term in the Code, the spec-

92. *Id.* at 754
93. *Id.* at 753.
94. *Id.* at 754 (citations omitted).
95. Milavetz, Gallop & Milavetz, P.A. v. United States, 130 S. Ct. 1324 (2010).
96. *Id.* at 1329.
97. 11 U.S.C. § 101(12A) (2006).
98. *Milavetz, Gallop & Milavetz, P.A.*, 130 S. Ct. at 1332 (citations omitted).
99. *Id.*
100. *Id.* at 1334.
101. *Id.* at 1335–36.

ified remedies, and congressional intent, the Court concluded that the phrase properly means "the thought of declaring bankruptcy because of the inability to continue current financial operations, often coupled with action designed to thwart the distribution of assets in a bankruptcy proceeding."[102]

Thus, the phrase "in contemplation of bankruptcy" as used in the statute already necessarily includes a negative motive or purpose to the effect it inappropriately removes assets from creditors or inappropriately hinders creditor recovery. As interpreted by the Court, "the phrase refers to a specific type of misconduct designed to manipulate the protections of the bankruptcy system."[103] Because the challenge to the statute was based on constitutional vagueness and the Court had reversed the lower courts, the Court did not proceed to consider the First Amendment challenge. However, the Court considered the First Amendment issue with respect to Code § 528's disclosure requirements holding there was no constitutional issue because the "challenged provisions impose a disclosure requirement rather than an affirmative limitation on speech."[104]

Therefore, this opinion has put to rest the issue of § 528 disclosure requirements as well as confirming that attorneys can be debt relief agencies under the Code. The opinion also provides important guidance as to the meaning of "in contemplation of bankruptcy" by reading into the phrase an abusive or improper motive. This interpretation will likely have a broader impact than just this opinion, given this phrase's use in the law generally and in the Code specifically. And while the prohibition on advising a client to incur new debt survived this constitutional challenge, the opinion provides guidance that discussing the potential incurrence of new debt for *bona fide* purposes free of abusive motive may not be prohibited by the statute. The opinion also leaves open a potential First Amendment challenge to the statute; although, as the phrase has now been interpreted, the challenge seems unlikely to succeed because the prohibition is limited to advising a client to engage in abusive and potentially illegal conduct.

B. *In re* Talsma[105]

In *Talsma*, Judge D. Michal Lynn of the U.S. Bankruptcy Court for the Northern District of Texas considered whether a Chapter 11 debtor-in-possession could retain a professional (in this case an accounting firm) with a prepetition claim against the debtor. The debtor, a dairy farm, sought to retain an accounting firm the court described as one of only a few accounting firms located in the debtor's rural area specializing in the debtor's dairy business. The U.S. trustee objected, arguing the accountant was not disinterested for purposes of retention under § 327 of the

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102. *Id.* at 1334 (quoting Black's Law Dictionary 336 (8th ed. 2004)).
103. *Id.* at 1336.
104. *Id.* at 1339, 1341.
105. *In re* Talsma, 436 B.R. 908 (Bankr. N.D. Tex. 2010).

Code unless the accountant waived its claim of approximately $11,700 (which qualified them as one of the debtor's twenty largest unsecured creditors).

The bankruptcy court therefore confronted the interplay between Code § 327 and § 1107, the latter of which provides: "Notwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title by a debtor in possession solely because of such person's employment by or representation of the debtor before the commencement of the case."[106] The court began its analysis by concluding that as a prepetition creditor, the accountant was not disinterested and therefore could not be retained under § 327(a) of the Code.[107] The court noted that most opinions conclude that § 1107 does not permit employment of a prepetition professional if the professional holds a claim against the estate; the section merely provides that prior employment is not a disqualification, and prior employment and a claim are two separate matters. A minority of opinions, on the other hand, conclude that prior employment with a prepetition claim on account of such prior employment necessarily contemplates a potential claim against the estate, and because § 1107 excepts prior employment as a disqualification, it necessarily also excepts a prepetition claim as a disqualification.

Reviewing the language of § 1107, the court stated the majority gives undue weight to the word "solely" in the statute and insufficient weight to the opening clause, "notwithstanding § 327(a)."[108] The court applied the cannon of statutory interpretation that each statutory provision must have a purpose, noting that nothing in § 327(a) disqualifies a professional from being employed merely on account of prepetition employment and construing § 1107(b) to provide an exception for something that does not exist leaves the statute without a purpose (i.e., if prior employment is not a disqualification to begin with, then providing an exception merely from disqualification for prior employment is unnecessary or nonsensical).[109] "Therefore, for the words '[n]otwithstanding section 327(a) of this title' to have any effect, section 1107(b) must do more than exempt professionals from disqualification based on just the fact of prepetition employment by the debtor."[110] The court found further support for the minority view in the Bankruptcy Act which does not require disinterestedness under Chapter XI of the Act, but requires it for a trustee and his professionals.[111] The court further noted that sound policy favored the minority view: a debtor-in-possession is like any person and should be able to choose its own professionals, and adopting the majority view might encourage a debtor to pay its professionals on the eve of bankruptcy, which would not conserve cash and may lead to avoidance litigation.

106. 11 U.S.C. § 1107(b) (2006).
107. *Talsma*, 436 B.R. at 911.
108. *Id.* at 913.
109. *Id.*
110. *Id.* at 913–14.
111. *Id.* at 916.

Accordingly, the court adopted the minority view and held the debtor could retain the accountant even though the accountant held a prepetition claim and the accountant did not waive such claim.[112] The court cautioned, however, that § 107(b) was not *carte blanche* authority; while it excused the fact of employment and the resulting claim from § 327(a), there are other circumstances that may lead to disqualification under § 327(a) such as a professional-creditor serving on a committee or being able to control a class under the plan.

This is an interesting opinion that represents an apparent change in prior Northern District of Texas law. On one hand, it will facilitate employment of prepetition professionals and should therefore aid with a reorganization in the earlier stages of a Chapter 11 case. On the other hand, it remains to be seen whether this opinion will affect boutique reorganization firms and what the overall effect may be. It will also be interesting to see if professionals voting their claims under a plan are affected, and whether such non-insider votes can be challenged—albeit that a professional will vote his claim against a plan submitted by his client is unlikely.

XI. PROPERTY OF THE ESTATE

A. *In re* Texas Wyoming Drilling, Inc.[113]

Discussed above in Section IV at length is Judge Lynn's opinion in *Texas Wyoming Drilling, Inc.* as it relates to postconfirmation prosecution of causes of action. However, the opinion addresses a second issue of significant importance, even if not frequently applied. Namely, does the trustee have standing to prosecute preconfirmation causes of action in light of the postconfirmation conversion of the case to Chapter 7 even if the reorganized debtor would not have such standing? The court concluded the trustee does have such standing.[114] In the process, the court provides significant guidance on the application of § 348 of the Code.

The court began by noting that the avoidance actions the trustee sought to prosecute were property of the estate as of the petition date and at all times postconfirmation. *United Operating* concluded that a postconfirmation debtor lacked *standing* to prosecute the causes of action; however, *United Operating* did not conclude that the causes of action themselves had been extinguished.[115] Because the issue is one of standing, it may be that one person lacks standing to prosecute a claim while another person has such standing as long as the cause of action still exists. Therefore, just because a postconfirmation debtor (or other entity) may lack standing does not by itself lead to the conclusion that a trustee would also lack

112. *Id.*

113. Spicer v. Laguna Madre Oil & Gas II, L.L.C. (*In re* Tex. Wyo. Drilling, Inc.), 422 B.R. 612 (Bankr. N.D. Tex. 2010).

114. *Id.* at 637–38.

115. *Id.* at 626.

such standing under the defendants' argument that the trustee does nothing more than step into the shoes of the postconfirmation debtor.

The court analyzed § 348 as the applicable statutory provision. Under § 348 of the Code, the effects of conversion are governed by two dates—the date of conversion and date of the commencement of the case. Unless a particular Code section listed in § 348 is being changed by conversion, that conversion does not change the date of the case's commencement. Section 541 defines estate property as property of the estate on the date of commencement. Because § 348 does not list § 541 as triggered by the conversion date, the date of commencement of the case is not affected or changed by the conversion. Thus, the original petition date remains the date of commencement under § 541 of the Code notwithstanding the conversion. The court noted that other courts are split on the question of whether property "revests" in the estate postconfirmation.[116] However, because the Code provides for either the remedy of dismissal or conversion in the event of a default under a confirmed Chapter 11 plan, the potential of a conversion must have meaning and there must be a Chapter 7 estate to administer. Otherwise, what would be the point of a conversion and who would own the property remaining postconfirmation? Accordingly, "property that has not been disposed of by the debtor is reinstated as property of the chapter 7 bankruptcy estate upon conversion."[117]

Therefore, because conversion is specifically provided for in the event of a plan default and conversion does not change the commencement date of a case and because § 541 speaks in terms of estate property as of the commencement of a case, the property of the converted estate consists of the estate property on the petition date, except the property the debtor disposed of since that date.[118] Thus, even if the postconfirmation debtor lacked standing because the claims had not been disposed of by judgment and were not extinguished, they revested in the estate and the trustee has authority to administer assets of the estate under the Code.[119]

This conclusion has applications past its holding. First, the court concluded that postconfirmation property revests in the converted estate.[120] While postconfirmation conversions are rare (as opposed to dismissals), this opinion addresses perhaps the most fundamental question raised by this scenario: what property does the converted estate consist of? Second, this opinion concludes that a cause of action that may be challenged for a lack of standing under *United Operating*, is not itself disposed of or extinguished.[121] Finally, this opinion confirms that even if one person lacks standing over a cause of action, another person may have such standing (also confirmed by the Fifth Circuit in *Louisiana World Exposi-*

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116. *Id.* at 633.
117. *Id.*
118. *Id.*
119. *Id.* at 633–34.
120. *Id.* at 634.
121. *Id.*

tion).[122] This opinion may even provide a potential mechanism for resurrecting valuable and important causes of action otherwise lost under a confirmed plan.

As noted above, this opinion is on direct appeal to the Fifth Circuit and practitioners are encouraged to research the results, which will almost certainly be addressed in next year's Survey.

B. *In re* Moore[123]

The *Moore* case considered two matters of first impression: (1) is a cause of action belonging to an estate an asset the trustee can sell and (2) does a trustee's proposed settlement of an estate's cause of action implicate the Code's sale provisions and principles such that if a creditor offered to buy the claims for more than the settlement amount, normal sale and auction procedures should have been followed. The Fifth Circuit answered both questions in the affirmative.[124]

Prior to the petition date, a creditor sued the debtor and various other persons and entities affiliated with the debtor. The creditor based its claims against the third parties on reverse veil piercing and fraudulent transfer. Once the debtor filed his Chapter 7 petition, the trustee succeeded to the fraudulent transfer and alter ego claims under prior Fifth Circuit precedent, and the creditor funded the trustee's continued litigation. The trustee eventually proposed a litigation settlement to the estate in the amount of $37,500—much less than the funds the creditor had advanced towards the litigation. The creditor therefore objected to the sale and offered the trustee $50,000 to buy the claims. The trustee, while noting that the creditor's offer was better, proceeded with the settlement. The bankruptcy court approved the settlement, concluding as a matter of law that the causes of action could not be sold and based its ruling on that conclusion.[125]

The court quickly concluded that the trustee may generally sell causes of action as property of the estate under § 363 of the Code similar to any other asset: "A trustee may sell litigation claims that belong to the estate, as it can other estate property, pursuant to § 363(b)."[126] With respect to the specific causes of action here, the Fifth Circuit reviewed its precedent, such as *In re S.I. Acquisitions*[127] and *In re Mortgage America Corp.*,[128] and noted a trustee may augment property of the estate through avoidance actions including those assertable by creditors under § 544. Accordingly, the court concluded that both the alter ego cause of action and the

122. *Id.* at 637–38.
123. The Cadle Co. v. Mims (*In re* Moore), 608 F.3d 253 (5th Cir. 2010).
124. *Id.* at 266.
125. *Id.* at 257.
126. *Id.* at 257–58.
127. See generally *S.I. Acquisition, Inc. v. Eastway Delivery Serv. (In re S.I. Acquisition)*, 817 F.2d 1142 (5th Cir. 1987).
128. See generally *Am. Nat'l Bank v. Mortgage Am. Corp. (In re Mortgage Am. Corp.)*, 714 F.2d 1266 (5th Cir. 1983).

fraudulent transfer cause of action were property of the estate.[129] The Fifth Circuit confirmed its precedent in this respect, which has been questionable. The court also rejected certain cases which found a trustee may not sell causes of action that the trustee has authority over pursuant to Code § 544. Thus, because the causes of action were estate property, they could be sold by the trustee under § 363 of the Code.[130]

Next, addressing the interplay between a settlement and sale, the court noted that "[w]hether a trustee's proposed compromise of estate claims can constitute a proposed sale of estate property that triggers § 363 sale provisions is an issue of first impression in this circuit."[131] It reviewed the various standards applicable to Bankruptcy Rule 9019 and § 363(b) sales noting that "[a] trustee has the duty to maximize the value of the estate."[132] The court also noted a split between other circuits when faced with this issue on whether the associated rule(s) of Rule 9019 or § 363(b) control. Ultimately, the court agreed with opinions applying the sale standards of § 363(b) to a proposed settlement: "The proposed compromise was a disposition of estate property. Cadle's higher offer obligated the bankruptcy court to consider whether an auction and § 363 sale were appropriate . . . . Whether to impose formal sale procedures is ultimately a matter of discretion' that we leave to bankruptcy courts."[133]

Finally, the Fifth Circuit noted one or both provisions may apply depending on the mechanism pursued by the trustee:

> In the event an auction is held and the trustee selects defendants' offer, the bankruptcy court must assess the transaction as both a proposed sale under § 363 and a proposed compromise under rule 9019. Procedures under that rule would not be invoked, however, were the trustee to accept Cadle's bid, because the transaction would not constitute a proposed settlement.[134]

What is not answered is whether, in the absence of a party interested in purchasing the causes of action, the bankruptcy court must assess the settlement as both a proposed sale and a proposed compromise. Or is the settlement just a proposed compromise under Rule 9019? Of course, in the absence of someone interested in purchasing the cause of action, the end result and factors employed by the bankruptcy court may be the same.

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129. In re Moore, 608 F.3d at 258–59, 262.
130. *Id.*
131. *Id.* at 263.
132. *Id.*
133. *Id.* at 265 (quoting Goodwin v. Mickey Thompson Entm't Group, Inc., 292 B.R. 415, 422 (B.A.P. 9th Cir. 2003)).
134. *Id.* at 266.

XII. TAX CLAIMS

A. *In re* Kizzee-Jordan[135]

In *Kizzee-Jordan*, the Fifth Circuit analyzed the appropriate Chapter 13 plan interest rate for an *ad valorem* real property tax claim sold to Tax Ease Funding. As practitioners may be aware, Texas law was changed several years ago to provide for a third-party payment of one's real property taxes and an assignment of the tax claim with resulting lien rights to such third party to secure the land owner's repayment to the same (usually at a higher interest rate than the one provided to the taxing authorities for the tax claim). The question was whether the assignment of Tax Ease Funding's claim was a tax claim within the meaning of § 511 of the Code such that it could not be modified under the debtor's Chapter 13 and Chapter 11 plan. Here, the plan provided for a 5% interest rate on the claim. The bankruptcy court, holding the tax claim was extinguished when paid by Tax Ease, found the plan could modify the debtor's "new" note obligation to Tax Ease.[136] The Fifth Circuit disagreed.[137]

The Fifth Circuit analyzed § 511 of the Code and confirmed that "[i]t is now clear that when a federal, state, or local governmental entity pursues a claim against a bankrupt for unpaid taxes, the applicable interest rate is determined in accord with nonbankruptcy law."[138] However, the statute is not entirely clear whether a "tax claim" as used in the statute remains a "tax claim" when held by a third party who pays the underlying taxes. Construing the statutory language, the Fifth Circuit noted that "[i]n the simplest terms, a tax claim is a broad right to payment of taxes."[139] The court next noted that § 511 of the Code applies to "creditors." Because the Code separately defines and employs the phrase "governmental unit," the court decided that had Congress intended to limit § 511 only to a tax claim held by a governmental unit, Congress could have easily employed the term "governmental unit" instead of the broader term "creditor" in § 511. Analyzing Texas law, the court further held that Texas statutes entitled Tax Ease to exercise any and all rights and remedies of the transferring tax unit.[140] Finally, analyzing the argument that the payment by Tax Ease extinguished the underlying tax lien, the Fifth Circuit held as follows:

> If the tax claim against the property owner were extinguished, the tax collector would issue the tax receipt to that property owner, not the transferee. By allowing a transferee to pay the taxes and receive the tax receipt and lien, the statutory scheme changes only the entity to which the Thompsons are indebted for the taxes originally owed,

135. Tax Ease Funding L.P. v. Thompson (*In re* Kizzee-Jordan), 626 F.3d 239 (5th Cir. 2010).
136. *Id.* at 241.
137. *Id.* at 244.
138. *Id.* at 242–43.
139. *Id.*
140. *Id.* at 244.

> not the nature of the underlying debt upon which the claim is based. We do not think the tax lien otherwise could be properly transferred if the tax debt was extinguished.[141]

Even though Tax Ease had different rights than the taxing authorities (namely that it could charge considerably higher interest) the court concluded the underlying claim was still a tax claim within the meaning of § 511 of the Code such that the interest could not be modified under a plan.[142]

Interestingly, the court did not consider other potential claim modifications except the applicable interest. For example, under §§ 1129(a)(9)(C) and (D) of the Code, a Chapter 11 plan may repay a secured tax claim over five years. However, these sections reference back to § 507(a)(8) which specifically applies to claims by a "governmental unit." One basis of the court's opinion is that § 511 employs the term "creditor" instead of a "governmental unit." Given that logic, it appears that § 507(a)(8) and § 1129(a)(9) of the Code would not apply to a tax claim assigned to a third party lender. If so, then the claim may be treated under the plan rather than through periodic cash payments within five years of the petition date, so long as the interest rate is not modified. For example, the claim could accrue postpetition and postconfirmation interest, but be repaid through a balloon payment at some point in the future upon a sale, which may be more than five years after the petition date. Whether this logical result of the Fifth Circuit's analysis is correct remains to be seen.

XIII. TRUSTEE LIABILITY

A. *In re* Texas Pig Stands, Inc.[143]

In *Texas Pig Stands, Inc.*, the Fifth Circuit considered whether a Chapter 11 trustee was *personally* liable for postpetition sales taxes. The trustee, apparently because of cash flow problems and a desire to get the debtors to confirm the plan, failed to pay postpetition sales taxes on a plan of reorganization where the debtors' restaurants would be sold. The bankruptcy court held the trustee was not personally liable absent gross negligence.[144] The issue involved the language of the confirmed plan and implementation of the trust agreement, which the bankruptcy court believed absolved the trustee from liability absent gross negligence.

The trustee proceeded *pro se* before the circuit arguing that "the mere 'deferral' of tax payments was implicitly or explicitly authorized under bankruptcy law, which allegedly supersedes state tax law in this respect."[145] The Fifth Circuit disagreed.[146] Noting Texas law imposes per-

141. *Id.* at 244–45.
142. *Id.* at 246.
143. Tex. Comptroller of Pub. Accounts v. Liuzza (*In re* Tex. Pig Stands, Inc.), 610 F.3d 937 (5th Cir. 2010).
144. *Id.* at 940.
145. *Id.* at 942.
146. *Id.* at 945.

sonal liability on a controlling person for nonpayment of taxes, here the trustee knew that the taxes were due and he used the money to pay other creditors. Thus, the trustee's failure to pay the taxes was willful under prior precedent construing the tax statutes. With respect to the argument that the trustee had a duty to maximize the value for the estate and that his good intentions absolved him of liability, the circuit noted that "[g]ood intentions are irrelevant" when it comes to payment of these taxes.[147] The circuit held that the trustee mistakenly relied on prior precedent concerning a trustee's potential liability: "That a trustee is only liable to the estate for acts of gross negligence, has nothing to do with a statutory duty to the state to pay taxes held in trust."[148] Moreover, 28 U.S.C. § 959 and § 960 require that a business be operated in conformity with nonbankruptcy law, and specifically require the timely payment of state taxes. Finally, the circuit noted that the funds in question were trust funds collected by the debtors and although they became property of the estate, § 541(d) of the Code limited what the trustee could do with these funds and the trustee was not free to dispose of them.[149]

The message is clear: Beware if you are a Chapter 11 or Chapter 7 trustee operating a business. You must ensure that postpetition trust funds and other taxes are timely paid; do not rely on a debtor to do it for you (especially in a case like *Texas Pig Stands* where the debtor had serious cash flow problems). You may face personal liability if you collect trust fund taxes and fail to pay them to the appropriate authority. Moreover, do not rely on customary quasi-judicial immunity, plan language, or language in a trust agreement to absolve you. If you rely on a plan document, ensure that the plan and the confirmation order clearly contain provisions absolving you of liability or enjoining any personal actions against you. However, the bankruptcy court may not be permitted to issue such protections if objected to by the taxing authorities because they would effectively constitute a nonconsensual third party release.

XIV. CONCLUSION

By the time this article is published or shortly thereafter, several important opinions will have been issued—the Supreme Court will have decided the bounds of bankruptcy court claims adjudication in the *Stern v. Marshall*[150] matter, the Fifth Circuit will have decided the judicial estoppel issue *en banc* as well as refined the issue of claim retention under a plan. These opinions will be discussed in next year's Survey and the practitioner will very likely be familiar with them. At the same time, this article discusses various other important opinions, and the practitioner is encouraged to familiarize himself with these opinions and to follow their progress through the appellate courts if applicable. The authors hope this

147. *Id.*
148. *Id.* at 943 (citation omitted).
149. *Id.* at 945.
150. 131 S. Ct. 2594 (2011).

article, together with their thoughts on the cases addressed herein, provides the practitioner with guidance and potential ideas that will help enable the bankruptcy bar to continue providing excellent service to its clients, the courts, and the bankruptcy system which we all serve.