BANKRUPTCY

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The Fifth Circuit was busy handing down decisions on bankruptcy issues during the survey period. The author has reviewed seventeen of these cases and has passed on several where the result was too fact-intensive. This year's results do not bear out the truism that if you lose in the bankruptcy court, forget the appeal. Seven of the reviewed cases resulted in reversals. Eight cases were affirmed. Two were dismissed as moot, which had the same effect as an affirmance.

Despite the high reversal rate this year, the lesson remains the same: For maximum leverage on appeal, win in the bankruptcy court. Note, however, that this seemingly high reversal rate of bankruptcy court decisions can be misleading. What we do not see by looking at the numbers is the multitude of cases decided by the bankruptcy courts that did not generate an appeal. These cases reflect the success of the bankruptcy courts in resolving disputes without calling upon the appellate courts.

PREFERENCES

In *In re Lamar Haddox Contractor, Inc.*,[1] the court reversed the bankruptcy and district courts' decisions and found no preference because the evidence to prove the debtor's insolvency was insufficient under a clearly erroneous standard.[2] Where there is an "insider" guarantor, an avoidable preference occurs when the debtor pays an antecedent debt within one year prior to the filing of the bankruptcy petition and when the payment occurs while the debtor is insolvent.[3]

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1 Orix Credit Alliance, Inc. v. Harvey (*In re* Lamar Haddox Contractor, Inc.), 40 F.3d 118 (5th Cir. 1994).

2 *Id.* at 120. A reviewing court must accept the bankruptcy court's findings of fact unless they are clearly erroneous. *Id.* (citing Wilson v. First Nat'l Bank (*In re* Missionary Baptist Found. of Am., Inc.), 796 F.2d 752, 756 (5th Cir. 1986); Clay v. Traders Bank, 708 F.2d 1347, 1350 (8th Cir. 1983)).

3 *See id.* at 120-21; *see also* 11 U.S.C. § 547(b)(4)(B) (1988); Levit v. Ingersoll Rand Fin. Corp. (*In re* V.N. Deprizio Constr. Co.), 874 F.2d 1186 (7th Cir. 1989) (Transfer to non-insider creditor occurring within a year of the filing for bankruptcy may be awarded as preferential when the transfer benefitted an insider.). *Deprizio* was legislatively overruled by amendment to 11 U.S.C. § 550(a), effective October 22, 1994. *See* The Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (codified in scattered sections of 11

Note, however, that the ordinary rule—that insolvency is a rebuttable presumption—is not applied when the alleged preference occurred more than ninety days prior to the filing of the petition. Thus, if the preference falls outside of the ninety-day window, the trustee must prove insolvency by a preponderance of the evidence.[4]

Judge Duplantier,[5] writing for the Fifth Circuit, delivered a wake-up call to trustees to think carefully about the proof presented to prove insolvency. First, the court looked at 11 U.S.C. § 101(32)(A) and observed that a corporate debtor is insolvent when its "financial condition [is] such that the sum of [its] debts is greater than all of [its] property, at a fair valuation."[6] This is known as the "balance sheet test."[7] But the inquiry does not stop with the values on the balance sheet. A fair valuation requires a closer look at the assets.

As the court observed, with an "Accounting 101" lecture, financial statements reflect the book value of assets.[8] The book value of an asset is ordinarily its cost minus depreciation, and depreciation is usually amount determined by tax law.[9] Thus, the fair value of an asset may be different than the balance sheet value. Implicit in this logic is that the rate of depreciation is artificial and not necessarily a fair value.

So what does the court believe to be a fair value? An even more uncertain test is applied—"estimating what the debtor's assets would realize if sold in a prudent manner in current market conditions."[10] This test will prove to be mischievous in a bankruptcy case. Appraisals or opinion testimony of the actual value of the debtor's assets will be required by the test. Often, by the time preference suits are instituted, the debtor's assets are long gone. And ordinarily, the debtor's assets will have been disposed of by liquidation at

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U.S.C.). Except for the *Deprizio* issue, the issue in preference case ordinarily involves transfers made within the 90-day period before the filing of the bankruptcy case.

4 *In re* Lamar Haddox Contractor, Inc., 40 F.3d at 121.

5 Senior Judge, United States District Court for the Eastern District of Louisiana, sitting by designation. *Id.* at 119.

6 *Id.* at 121.

7 *See, e.g.*, *In re* Taxman Clothing Co., Inc., 905 F.2d 166 (7th Cir. 1990).

8 *In re* Lamar Haddox Contractor, Inc., 40 F.3d at 121.

9 *Id.*

10 Pembroke Dev. Corp. v. Commonwealth Sav. & Loan Ass'n (*In re* Pembroke Dev. Corp.), 124 B.R. 398, 401 (Bankr. S.D. Fla. 1991).

distress prices. How will trustees reconstruct the value of the pre-bankruptcy assets at the time of the payment to the creditor?

With some luck, there may be some extant appraisals of assets, but most businesses, especially financially distressed ones, will not have appraisals in their corporate records. As a result, the trustee may have to rely solely upon opinion testimony. This approach will not only be difficult to prove, but it will also be equally difficult to defend. If there are no appraisals and the trustee relies exclusively on the opinion testimony of management to prove insolvency, the defendant creditor will have little defense other than the balance sheet. While most debtors will not have appraisals in their records, they will have a balance sheet.

What did the court reject in this case as proof of insolvency? The court rejected the testimony of the debtor's accountant who had prepared the debtor's tax returns and financial statements for over a decade.[11] Because the debtor's accountant has no information as to the fair value of the equipment, the court concluded that her testimony was insufficient to prove insolvency, though her opinion was that the debtor was "probably bankrupt."[12]

The court stated that "there is evidence that the book value of the assets *probably* was not reflective of the property's fair value,"[13] but the court did not tell us what that evidence was. Next, the court complained that the trustee's failure to introduce the financial statement that showed book value into the record prevented the court from determining the fair market value of the assets.[14] The court went on to reject the accountant's testimony, which did not include exhibits, as conclusory.[15] The court also noted that there was no testimony at all as to the fair value of the property, only its book value.[16]

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11 *In re* Lamar Haddox Contractor, Inc., 40 F.3d at 121

12 *Id.*

13 *Id.* (emphasis added).

14 *Id.* at 122.

15 *Id.*

16 *Id.*

In light of the clearly erroneous standard applied, the court's conclusion is troublesome. The Fifth Circuit's decision may stop trustees in their tracks and require a burden that may be impossible to establish. But this is double-edged joy for creditors because rebutting opinion testimony about assets that are no longer around will require considerable reconstructive analysis of the value of the debtor's assets.

CLAIMS

At issue in *In re Midland Industrial Service Corp.*[17] was whether the obligation of the debtor to pay personal property tax in Texas was a pre-petition or post-petition claim against the debtor.[18] Midland Central Appraisal District (MCAD) filed an administrative expense claim under 11 U.S.C. § 503 against the estate for 1988 ad valorem taxes to which the debtor had objected.[19]

The court first observed that state law determines the question of when a tax obligation arises.[20] Under Texas law, property taxes are the personal obligation of the person who owns or acquires the property on January 1 of the year for which the tax is imposed.[21] Texas law also provides that on January 1 of each year, a tax lien attaches to the property to secure payment of the taxes.[22] However, taxes for a particular tax year are not actually assessed against the taxpayer until approximately October 1.[23]

MCAD argued that the tax is not incurred until the date it is assessed. In this case, assessment occurred post-petition, as the petition was filed in mid-January. The debtor argued that under state law, the tax was incurred on January 1, which was pre-petition.[24]

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17 35 F.3d 164 (5th Cir. 1994).

18 *Id.* at 165.

19 *Id.*

20 *Id* at 166 (citing *In re* Columbia Gas Sys., Inc., 146 B.R. 114, 116 (Bankr. D. Del. 1992), *aff'd,* 37 F.3d 982 (3d Cir. 1994), *cert. denied*, 115 S.Ct. 1793 (1995)).

21 TEXAS TAX CODE ANN. § 32.07 (West 1995).

22 *Id.* §§ 32.01(a).

23 Shaw v. Phillips Crane & Rigging, Inc., 636 S.W. 2d 186 (Tex. 1982), *appeal dismissed,* 459 U.S. 1191 (1983).

24 *In re* Midland Indus. Serv. Corp., 35 F.3d at 166.

The Fifth Circuit turned to *Black's Law Dictionary* for the definition of "incur"[25] and concluded that the tax claim is incurred on the date it accrues rather than the date it is assessed.[26] Under Texas law, liability based on ownership accrues on January 1, which, in this case, was pre-petition. Accordingly, MCAD had a pre-petition tax lien, which it failed to enforce, but not a post-petition administrative claim.[27]

APPELLATE JURISDICTION

Just when you think you have figured out appellate jurisdiction, another case pops up to demonstrate a nuance that reminds you of its complexity: *In re Aucoin*.[28] Consider these facts: Debtor objects to the bankruptcy court's order extending a creditor's time to object to the discharge.[29] Debtor argues that the creditor's potential objections relate to dischargeability under 11 U.S.C. § 523,[30] but that the creditor's motion refers only to section 727[31] objections to discharge. The bankruptcy court grants the creditors's motion to extend; the district court affirms and holds that the extended deadline applied to both the section 727 and section 523 complaints. The case is appealed to the Fifth Circuit.[32]

Flash back to the 1991 Fifth Circuit decision of *In re Ichinose*.[33] In that case, the court denied the debtor's motion to dismiss a section 523 complaint as untimely, but Judge Patrick Carr reversed on appeal to the district court.[34] The Fifth Circuit affirmed on the merits.[35]

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25. *Id.* at 166-67.
26. *Id.* at 167 & n.2 (citing *In re* Northeastern Ohio Gen. Hosp. Assn., 126 B.R. 513 (Bankr. N.D. Ohio 1991); *In re* Brent Explorations, Inc., 91 B.R. 104 (Bankr. D. Colo. 1988)).
27. *In re* Midland Indus. Serv. Corp., 35 F.3d at 167.
28. 35 F.3d 167 (5th Cir. 1994).
29. *Id.* at 169.
30. 11 U.S.C. § 523 (1994).
31. 11 U.S.C. § 727 (1994).
32. *In re* Aucoin, 35 F.3d at 169.
33. Ichinose v. Homer Nat'l Bank (*In re* Ichinose), 946 F.2d 1169 (5th Cir. 1991).
34. *Id.* at 1171.
35. *Id.* at 1175-77.

What did the *Aucoin* court do in what appears to be a similar procedural dispute? The *Aucoin* court dismissed the case because it lacked jurisdiction.[36] Repeat: *Aucoin* case dismissed, no jurisdiction; *Ichinose* decided on the merits.

One has to closely examine 28 U.S.C. § 158(a) and (d) to see the difference. First, district courts have jurisdiction to hear appeals from final and interlocutory judgments as well as orders of the bankruptcy court.[37] In both *Aucoin* and *Ichinose,* the order that went to the district court was interlocutory.[38]

The Fifth Circuit, in contrast, only has jurisdiction of appeals from final orders.[39] "A decision is final when it ends the litigation on the merits and leaves nothing for the court to do but execute the judgment."[40] In *Ichinose*, the district court reversed the bankruptcy court's order, which had the effect of ending the litigation. The *Aucoin* district court, in contrast, affirmed an order denying a motion that would have effectively ended the litigation. While both *Ichinose* and *Aucoin* started as appeals from an interlocutory order of the bankruptcy court, the district court's reversal in *Ichinose* transformed its interlocutory nature into a final order.[41] Thus, the *Aucoin* and *Ichinose* cases, when they arrived at the Fifth Circuit, were procedurally different. Although the two cases were quite similar factually —the debtor was hoping for a decision to avoid a trial on the merits,[42] the transmutation that occurred at the district court influenced the determination of whether the Fifth Circuit had jurisdiction to hear the appeal.

Who said that the rules of procedure for appeals were easy? Consider *Christopher v. Diamond Benefits Life Insurance Co.,*[43] in which a Chapter 11 debtor brought a single adversary proceeding seeking a declaration that certain claims in state court of four groups of creditors had been discharged in his bankruptcy case.[44]

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36 *In re* Aucoin, 35 F.3d at 170.

37 28 U.S.C. § 158(a) (1988).

38 *In re* Aucoin, 35 F.3d at 169; *In re* Ichinose, 946 F.2d at 1176.

39 28 U.S.C. § 158(d) (1988).

40 Askanase v. LivingWell, Inc., 981 F.2d 807, 810 (5th Cir. 1993).

41 In re Ichinose, 946 F.2d at 1177.

42 The author speaks with some authority since he and Professor James Bailey were debtor's counsel in the *Ichinose* case.

43 Christopher v. Diamond Benefits Life Ins. Co. (*In re* Christopher), 35 F.3d 232 (5th Cir. 1994) (per curiam).

44 *Id.* at 233-34.

The case was tried against all the defendants.[45] At trial, the bankruptcy court granted one group's oral motion to dismiss (the "Diamond Benefits Group") and later executed a written judgment. The debtor filed a motion for rehearing that was denied.[46]

Subsequently, the bankruptcy court rendered judgment for the debtor against the other three groups of creditors (the "Other Groups").[47] The debtor filed his first notice of appeal from this judgment within ten days, but more than ten days after the denial of rehearing motion on the Diamond Benefits Group's judgment. After the notice of appeal was filed, one of the defendants in the Other Groups filed a motion for additional findings of fact. The court denied the motion.[48]

A month later, the Diamond Benefits Group filed a motion to dismiss the debtor's appeal as being untimely. The motion was denied.[49] The debtor then filed a motion for extension of time to file an appeal, which was granted without a hearing or reasons. The next day the debtor filed another —his second—notice of appeal. The Diamond Benefits Group simultaneously filed a cross-appeal and a motion for reconsideration on the order granting the debtor an extension of time to file an appeal. The motion for reconsideration was denied.[50]

On appeal, the district court found that the first notice of appeal was nullified by the Other Groups' motion for additional finding of fact.[51] The district court also found that the bankruptcy court had abused its discretion in granting the debtor additional time to file the second notice of appeal. Finally, the district court found that there was no excusable neglect for the tardiness of the second notice of appeal and, accordingly, reversed the bankruptcy court's order extending the time for filing the appeal.[52]

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45 *Id.* at 234.
46 *Id.*
47 *Id.*
48 *Id.*
49 *Id.*
50 *Id.*
51 *Id.*
52 *Id.*

The Fifth Circuit looked first to Rule 8002(a) of the Federal Rules of Bankruptcy Procedure, which requires a notice of appeal to be filed within ten days of the bankruptcy court's judgment.[53] The ten days is tolled by the filing of certain motions set out in Rule 8002(b).[54] Any notice of appeal filed before the disposition of a Rule 8002(b) motion is nullified because the time for appeal runs anew from the time the motion is granted or denied.[55]

The debtor argued that Diamond Benefits Group's cross appeal was nullified because it was filed at the same time as its motion to reconsider, which the debtor characterized as a Rule 8002(b) motion. The court of appeals disagreed and said that a motion for reconsideration is not the type of motion that will toll the appeal period under Rule 8002(b).[56] The court analogized tolling under Rule 8002(b) to tolling under Rule 4(a) of the Federal Rules of Civil Procedure and cited cases in support of its analogy, which held that a motion for reconsideration of a motion to dismiss an appeal does not toll the appeal period under Rule 4(a).[57] The court found that Rule 8002(b) is similar with regard

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53 FED R. BANKR. P. 8002(a); *In re* Christopher, 35 F.3d at 236.

54 FED. R. BANKR. P. 8002(b). Rule 8002(b) provides:

> Effect of Motion on Time for Appeal. If any party makes a timely motion of a type specified immediately below, the time for appeal for all parties runs from the entry of the order disposing of the last such motion outstanding. This provision applies to a timely motion:
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> (1) to amend or make additional findings of fact under Rule 7052, whether or not granting the motion would alter the judgment;
> (2) to alter or amend the judgment under Rule 9023;
> (3) for a new trial under Rule 9023; or
> (4) for relief under Rule 9024 if the motion is filed no later than 10 days after the entry of judgment. A notice of appeal filed after announcement or entry of the judgment, order, or decree but before disposition of any of the above motions is ineffective to appeal from the judgment, order, or decree, or part thereof, specified in the notice of appeal, until the entry of the order disposing of any of the above motions requires the party, in compliance with Rule 8001, to amend a previously filed notice of appeal. A party intending to challenge an alteration or amendment of the judgment, order, or decree shall file a notice, or an amended notice, of appeal within the time prescribed by this Rule 8002 measured from the entry of the order disposing of the last such motion outstanding. No additional fees will be required for filing an amended notice. *Id.*

55 FED. R. BANKR. P. 8002(b)(4); *In re* Christopher, 35 F.3d at 234.

56 *In re* Christopher, 35 F.3d at 235.

57 *See* Reinbold v. Dewey County Bank, 942 F.2d 1304 (8th Cir. 1991), *cert. denied* 503 U.S. 946 (1992); Fox v. Brewer, 620 F.2d 177 (8th Cir. 1980).

to the types of motions that will toll the time period for appeal.[58] Consequently, Diamond Benefits Group did not need to file a second notice of appeal.[59]

The debtor's second notice of appeal was clearly untimely, except for the order granting the extension of time. The debtor argued that the first notice of appeal from the Diamond Benefits Group's judgment should not have been nullified because the motion for additional findings of fact was filed by the Other Groups in response to a separate judgment. Thus, the two judgments should be treated individually, requiring separate notices of appeal. Under the debtor's theory, the motion for additional findings of fact was not a Rule 8002(b) motion as to the Diamond Benefits Group's judgment. One of the flaws in this argument is that the first notice of appeal was filed more than ten days after the Diamond Benefits Group's judgment.

The court distinguished a Sixth Circuit opinion that involved several consolidated cases and treated each party as being involved in separate actions.[60] In *Christopher*, the four groups were all co-defendants in the same action.[61] Thus, the separate judgments were not treated as separate for appeal purposes and required a notice to be filed within ten days of the disposition of the last Rule 8002(b) motion. Using this analysis, both notices of appeal filed by the debtor were found to be untimely.

Nevertheless, the court extended the Supreme Court's holding in *Pioneer Investment Services Co. v. Brunswick Associates Ltd., Partnership*, [62] interpreting Federal Rule of Bankruptcy Procedure 9006(b)(1) to this case in examining the excusable neglect of the debtor's attorney who filed untimely notices of appeal.[63] In *Pioneer*, the Supreme Court held that an attorney's inadvertence could constitute excusable neglect where a proof of claim was untimely filed because the bar date was buried in a stack of paper on his desk.[64] The Supreme Court stated that excusable neglect is an equitable

58 *In re* Christopher, 35 F.3d at 235.
59 *Id.*
60 Stacey v. Charles J. Rogers, Inc., 756 F.2d 440 (6th Cir. 1985) (relied upon by debtor).
61 *In re* Christopher, 35 F.3d at 235.
62 113 S.Ct. 1489 (1993).
63 *In re* Christopher, 35 F.3d at 235-36.
64 If this excuse is widely accepted, most attorneys will be excused from following the rules of procedure.

consideration "taking account of all relevant circumstances surrounding the party's omission."[65] Because the district court had excluded attorney negligence in examining excusable neglect, the Fifth Circuit remanded the case back to the bankruptcy court to render findings of fact to support its extension of time for the filing of the second notice of appeal.[66]

The debtor may be saved on remand in this case. But what do we learn for future cases? It is the same old lesson: Better safe than sorry. The filing of a notice of appeal will be nullified if there is a Rule 8002(b) motion filed and disposed of, whether it is denied or granted. Where multiple parties are involved and the court renders orders or judgments on separate pieces of paper at different times, a determination must be made as to how and why these co-defendants are in the same case. If the proceeding is a consolidated case, each judgment requires a separate notice of appeal. On the other hand, it appears that if the multiple co-defendants are in a single lawsuit, the separate judgments are ignored, and the court looks to the last disposition of a Rule 8002(b) motion.

Many attorneys who are alert to this problem fear malpractice and, consequently, compulsively file notices of appeal when in doubt. These fears of malpractice cause clerks to be flooded with superfluous notices of appeal. Hopefully, this administrative flood will inspire a simpler solution to this problem.

PROFESSIONAL FEES

Section 329(a) of the Bankruptcy Code requires a debtor's attorney to file with the court a statement of compensation paid or agreed to be paid "if such payment or agreement was made after one year before the date of the filing of the petition."[67] At issue in *Arens v. Boughton*[68] was appellant's argument that this section prevented a bankruptcy court from ordering the disgorgement of fees paid more than a year before the bankruptcy.[69] Debtor's counsel was obligated by a local rule[70] and Bankruptcy Rule

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65 *Pioneer Inv. Servs. Co.*,, 113 S. Ct. at 1498.
66 *In re* Christopher, 35 F.3d at 236.
67 11 U.S.C. § 329(a) (1994).
68 Arens v. Boughton (*In re* Prudhomme), 43 F.3d 1000 (5th Cir. 1995).
69 *Id.* at 1002.
70 BANKR. W.D. La. R. 40.

2014(a)[71] to disclose the compensation arrangement, all connections with the debtor, and any compensation paid in the eighteen-month, pre-petition period.

The bankruptcy judge, Henley Hunter, ordered the debtor's attorney to disgorge a $75,000 retainer after an evidentiary hearing prompted by a creditor.[72] The court found that the fee was paid in contemplation of bankruptcy, that it was excessive, and that the debtor's attorney breached his duty to disclose the retainer as well as a contingency interest in the debtor's cause of action against one of her creditors.[73] The order was affirmed at both the district and appellate court levels.[74]

When it comes to candor of counsel, the courts are, not surprisingly, very forgiving. The Fifth Circuit relied on several theories to affirm. One basis for the court's decision was that despite the timing of the payment, the retainer was paid in contemplation of a bankruptcy petition.[75] The court's observation —in a court of equity, a statute of limitations may be tolled by the inequitable conduct of the parties—revealed what was at the heart of this decision. The court obviously was upset that the retainer was not disclosed and labeled the attorneys' conduct as concealment.

The court also zeroed in on Bankruptcy Rule 2017(a), which provides that a court "may determine whether any payment of money . . . by the debtor . . . in contemplation of the filing of a petition . . . to an attorney for services . . . to be rendered is excessive,"[76] The rule has no time limit and is indicative of the court's broad discretion in awarding and denying attorney's fees in bankruptcy cases.

What's the lesson to debtor's counsel? Be forthright, candid, and err on the side of total disclosure. Otherwise, your actions will be judged severely and all fees could be disgorged as punishment, as was done to debtor's counsel in this case.

PROPERTY OF THE ESTATE

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71 FED R. BANKR. P. 2014(a)
72 *Arens*, 43 F.3d at 1002.
73 *Id.* at 1002-03.
74 *Id.* at 1005.
75 *Id.* at 1003.
76 FED. R. BANKR. P. 2017(a).

The trustee in *In re Simpson*[77] brought a fraudulent transfer adversary proceeding against the debtor who, the day before he filed his bankruptcy case, had executed a disclaimer of his inheritance.[78] Under Texas inheritance law, the effect of the disclaimer was to pass the property on to the debtor's son.[79]

The trustee argued that a transfer of property had occurred under section 548(a)[80] and that the inheritance should be part of the bankruptcy estate. Despite the broad definition of property in section 541,[81] the court stated that an "interest in property" is not a defined term under controlling federal law.[82] Therefore, one must look to state law.[83]

Hence, Texas law dictated the result. Texas law is also similar to the law applied by at least two other circuits[84] that have considered whether a disclaimer was a fraudulent transfer. Under Texas law, a valid disclaimer relates back to the death of the decedent, and the property passes as if the beneficiary died before the decedent.[85] Texas law holds that under the relation back doctrine, a beneficiary never possessed renounced property. Following the Seventh and Tenth Circuits, the Fifth Circuit rejected the reasoning of another Texas case[86] that found that the relation back doctrine was a legal fiction.

What's the lesson of this case? Timing is everything. Consider that under section 541(a)(5), property of the estate includes an interest of the debtor that the debtor "acquires or *becomes entitled to acquire"* within 180 days after a bankruptcy petition by inheritance.[87] Thus, a debtor anticipating an inheritance that he does not wish to share with his creditors may attempt to hold off the filing of his bankruptcy petition until after his

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77 Simpson v. Penner (*In re* Simpson), 36 F.3d 450 (5th Cir. 1994).

78 *Id.* at 452.

79 *Id.*

80 11 U.S.C. § 548(a) (1994).

81 *Id.* § 541.

82 *Simpson,* 36 F.3d at 452.

83 *See* Barnhill v. Johnson, 503 U.S. 393, 398 (1992) (noting that in a bankruptcy case, in the absence of any controlling federal law, "property" and "interests in property" are creatures of state law).

84 Jones v. Atchison (*In re* Atchison), 925 F.2d 209 (7th Cir.) (applying Illinois law), *cert. denied*, 502 U.S. 860 (1991); Hoecker v. United Bank, 476 F.2d 838, 841 (10th Cir. 1973) (applying Colorado law).

85 *Simpson*, 36 F.3d at 452.

86 Lowe v. Brajkovic (*In re* Brajkovic), 151 B.R. 402, 409 (Bankr. W.D. Tex. 1993).

87 11 U.S.C. § 541(a)(5) (1994) (emphasis added).

loved one dies. Otherwise, once the petition is filed, if his loved one dies within 180 days, he may not be able to renounce his interest in the inheritance.

EXTENSION OF TIME

Rogers v. Corrosion Products, Inc.[88] should set off bells and whistles to every lawyer who has not yet filed that cause of action against a debtor, believing that the prescriptive period has been suspended by the automatic stay. Go lift the stay now and file the suit. Otherwise, you may discover that you have a malpractice suit to defend.

Do I have your attention? Let's look at what the plaintiff's lawyer thought was the effect of section 108(c).[89] That section provides, in pertinent part:

> [I]f applicable nonbankruptcy law . . . fixes a period for commencing . . . a civil action in a court other than a bankruptcy court on a claim against the debtor . . . and such period has not expired before the date of the filing of the petition, then such period does not expire until the later of —(1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or (2) 30 days after notice of the termination or expiration of the stay under section 362 . . . .[90]

An involuntary petition had been filed against a debtor by several of its creditors.[91] A Louisiana citizen had been injured while working at the debtor's plant prior to the bankruptcy filing. After the involuntary petition was dismissed, the plaintiff filed his suit more than one year after his injury,[92] but less than a year after the dismissal.[93]

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88 42 F.3d 292 (5th Cir.), *cert. denied*, 115 S. Ct. 2614 (1995).

89 11 U.S.C. § 108(c) (1994).

90 *Id.*

91 *Rogers*, 42 F.3d at 293.

92 Louisiana requires delictual actions to be brought within a year. La. CIV. CODE ANN. art. 3492 (West 1994).

93 *Rogers*, 42 F.3d at 293.

The plaintiff's response to the debtor's summary judgment motion was that section 108(a) suspended the running of prescription during the pendency of the bankruptcy.[94] Not so, said the Fifth Circuit,[95] Since there is no state[96] or federal law that suspends prescription for delictual claims that arise in Louisiana, the plaintiff either has to file suit within the prescriptive period[97] or within thirty days of the termination of the stay which occurred upon dismissal of the case.[98]

The court noted that the Second and Ninth Circuits have also addressed this issue, as well as numerous other federal courts.[99] It will come as no surprise that decisions are divided. Nevertheless, the Fifth Circuit opted to base its decision on the "plain words of the statute" and found that section 108(c) does not create a separate tolling provision.[100]

Why ask now to lift the stay and file the suit? After all, if prescription runs during the pendency of the bankruptcy, section 108(c)(2) grants thirty days after the termination or expiration of the automatic stay to file your suit.[101] Can you say that you always receive every notice that is sent out in bankruptcy cases? Relying on notice of termination or expiration of the automatic stay can make one an insomniac.

DISCHARGE

94 *Id.* at 296.

95 *Id.* at 297.

96 The Louisiana Civil Code provides that "[p]rescription runs against all persons unless exception is established by legislation." La. CIV. CODE ANN. art. 3467 (West 1994). The plaintiff conceded that no applicable legislation suspends prescription in his case. *Rogers*, 42 F.3d at 294 n.1. However, in spite of the absolute terms of article 3467, Louisiana judicial doctrine recognizes an exception. The Fifth Circuit reviewed the judicial doctrine, *contra non valentem agere non currit praescripto,* and decided that the doctrine did not suspend prescription because of a bankruptcy petition. *Id.* at 294-95.

97 This requires that the plaintiff file a motion to life the stay of section 362 with the bankruptcy court and request permission to file the suit in the appropriate court for proper jurisdiction.

98 11 U.S.C. § 108(c) (1994).

99 *Rogers*, 42 F.3d at 296-97.

100 *Id.* at 297.

101 11 U.S.C. § 108(c)(2) (1994).

Another plain language case is *In re Fein*.[102] The court of appeals held that section 523(a)(1),[103] which excepts priority taxes from discharge,[104] means what it says.[105] Even though the IRS did not participate in the debtor's Chapter 11 case, either by filing a proof of claim or by appealing the confirmation order,[106] the court held that the debtor's priority tax liabilities were not discharged.[107]

Dennis v. Dennis[108] was decided based on the court's interpretation of section 523(a)(5) prior to the Bankruptcy Reform Act of 1994.[109] Although the case could have been decided after the amendments to section 523 with less analytical effort,[110] the case is still instructive.

At issue was whether an agreement by the debtor to pay the income taxes on his ex-spouse's one-half of her share of his pension was dischargeable.[111] The divorce dispute was governed by Texas law, which does not have alimony.[112] Using this state law peculiarity, the debtor apparently argued that since the Texas county court had found that the obligation to pay taxes was part of the division of community property between the parties and did not constitute alimony or child support, the obligation fell outside of the

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102 Fein v. United States (*In re Fein*), 22 F.3d 631 (5th Cir. 1994).

103 11 U.S.C. § 523(a)(1) (1994).

104 *Id.* § 507(a)(7).

105 *Fein*, 22 F.3d at 632-33.

106 Taxes were not addressed in the plan.

107 *Fein*, 22 F.3d at 634.

108 Dennis v. Dennis (*In re* Dennis), 25 F.3d 274 (5th Cir. 1994), *cert. denied*, 115 S. Ct. 732 (1995).

109 Pub. L. No. 103-394, 108 Stat. 4106 (1994) (codified in scattered sections of 11 U.S.C.).

110 Section 523(a)(15) was added by the Bankruptcy Amendments Act of 1994:

> A discharge . . . does not discharge an individual debtor from any debt . . . not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, a determination made in accordance with State or territorial law by a governmental unit unless—
>
> (A) the debtor does not have the ability to pay such debt from income or property of the debtor not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor and, if the debtor is engaged in a business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business; or
>
> (B) discharging such debt would result in benefit to the debtor that outweighs the detrimental consequences to a spouse, former spouse, or child of the debtor.

11 U.S.C. 523(a)(15) (1994).

111 *Dennis*, 25 F.3d at 275.

112 *Id.* at 277.

scope of section 523(a)(5) and, thus, was dischargeable.[113] The Fifth Circuit concluded that, given the peculiar facts of the case and despite the state court's characterization of the obligation, the obligation *was* either alimony, maintenance, or support, and as such, the obligation was not dischargeable under section 523(a)(5).[114]

The bankruptcy court said "it still smell[ed] like alimony or support" and found the debt not dischargeable.[115] The district court reversed, reasoning that the doctrine of collateral estoppel prohibited the bankruptcy court from looking behind the Texas county court's order.[116] The Fifth Circuit reversed the district court and reinstated the bankruptcy court's decision.[117]

Judge Johnson, writing for the panel, reminded us that since 1970, the determination of whether a debt is non-dischargeable is a matter of federal bankruptcy law, not state law.[118] "Bankruptcy courts must therefore look beyond the labels which state courts —and even parties themselves—give obligations which debtors seek to have discharged."[119] As a result, a spouse can argue to the contrary in state court yet still prevail in preventing the dischargeability of an alimony indebtedness in bankruptcy court.

The court cautioned that in discharge litigation, the bankruptcy courts should apply collateral estoppel only in limited circumstances. Those circumstances contemplate that the state court has made specific factual findings on issues that encompass the same prima facie elements as the bankruptcy issue.[120]

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113 *Id* at 279.

114 *Id.*

115 *Id.* at 277.

116 *Id.*

117 *Id.* at 279.

118 *See* Grogan v. Garner, 498 U.S. 279, 284 (1991); Brown v. Felsen, 442 U.S. 127, 136 (1979); Joseph v. J. Huey O'Toole, P.C. (*In re* Joseph), 16 F.3d 86, 87, (5th Cir. 1994); Biggs v. Biggs (*In re* Biggs), 907 F.2d 503, 504 (5th Cir. 1990).

119 *Dennis*, 25 F.3d at 277-78; *see* Davidson v. Davidson (*In re* Davidson), 947 F.2d 1294, 1296 (5th Cir. 1991); Benich v. Benich (*In re* Benich), 811 F.2d 943, 945 (5th Cir. 1987); Nunnally v. Nunnally (*In re* Nunnally), 506 F.2d 1024, 1027 (5th Cir. 1975).

120 *See* Sheerin v. Davis (*In re* Davis), 3 F.3d 113, 114-15 (5th Cir. 1993); Browning v. Navarro, 887 F.2d 553, 561 (5th Cir. 1989); Harold V. Simpson & Co. v. Shuler (*In re* Shuler), 722 F.2d 1253, 1256 (5th Cir.), *cert. denied.*, 469 U.S. 817 (1984).

Collateral estoppel is certainly inapplicable to a state court that does not recognize alimony as a remedy. Under Texas law, the court could characterize the agreement to pay taxes as nothing other than a property settlement.[121] The bankruptcy court was required to provide plenary review of the issue to determine the nature of the obligation.[122]

EXEMPTIONS

While the Fifth Circuit was cautioning the bankruptcy courts to conduct a plenary review in discharge cases even where the state courts had ruled on germane issues,[123] in *In re Youngblood*, the court slapped the bankruptcy court's hands for failing to totally defer to the IRS in deciding whether an IRA was exempt property under Texas law.[124]

The bankruptcy court entertained the argument of a creditor that the debtor's pension plan was not a "qualified" plan because it had violated the "exclusive benefit" rule.[125] Even though the IRS had twice before determined the debtor's plan to be "qualified," the bankruptcy court conducted an evidentiary hearing and held that the debtor's plan was not qualified and that the proceeds of the plan that rolled over into the debtor's IRA were not exempt property.[126] The district court affirmed.[127]

On appeal, the Fifth Circuit explained that an analysis of legislative intent is required in determining whether the IRA was exempt under the Texas statute.[128] Because Texas has no statutory or administrative rules relating to federal taxation, the court concluded Texas state courts would be required to look at federal tax law rather than independently decide whether a plan was "qualified" or not if the IRS had made a determination.[129] The Fifth Circuit concluded that the bankruptcy courts should not second guess the IRS in such a complex, specialized area.[130]

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121 *Dennis*, 25 F.3d at 278.
122 *Id.* at 279.
123 *Id* at 278.
124 Youngblood v. FDIC (*In re* Youngblood), 29 F.3d 225 (5th Cir. 1994).
125 *Id.* at 227.
126 *Id.* at 228.
127 *Id.* at 227.
128 TEX. PROP. CODE ANN § 42.0021 (West Supp. 1995).
129 *Youngblood*, 29 F.3d at 228.
130 *Id.* at 229.

In *Stoulig v. Traina*,[131] the Fifth Circuit adopted the reasoning of the district court[132] in a per curiam decision.[133] The court held that Rule 4003(b)[134] means what it says. An objecting party to a debtor's claimed exemptions must either file the objection or obtain an extension of time order within thirty days after the conclusion of the meeting of creditors. Although the trustee timely filed her motion to extend time for objections, she did not obtain an order granting the motion within thirty days after the conclusion of the creditor's meeting. Thus, the court held that the bankruptcy court had no jurisdiction to grant an extension of time to file exemptions after the lapse of the thirty-day objection period.

Perkins Coie v. Sadkin[135] is another per curiam decision dealing with the timeliness of filing objections to claimed exemptions. At issue was whether the debtor's purported claim of wrongful garnishment against Perkins Coie should be denied exemption status even though the objection was filed after the thirty-day limit imposed by Rule 4003(b).[136]

Perkins Coie raised several arguments in support of its position; all of which, the Fifth Circuit rejected *seriatim*.[137] The most significant argument pressed by Perkins Coie was that the debtor's claim that a wrongful garnishment cause of action is exempt property was itself a fraudulent act.[138] The court invoked Justice Clarence Thomas's literal approach to the interpretation of section 522(*l*)[139] and Rule 4003(b),[140] as set out in *Taylor v. Freeland & Kronz*.[141] According to Justice Thomas, if the thirty-day objection

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131 Stoulig v. Traina (*In re* Stoulig), 45 F.3d 957 (5th Cir. 1995) (per curiam).

132 *In re* Stouling, 169 B.R. 597 (E.D. La. 1994), *aff'd per curiam*, 45 F.3d 957 (5th Cir. 1995).

133 *Stoulig*, 45 F. 3d at 957.

134 Bankruptcy Rule 4003(b) provides in part:

> The trustee or any creditor may file objections to the list of property claimed as exempt within 30 days after the conclusion of the meeting of creditors held pursuant to Rule 2003(a) or the filing of any amendment to the list or supplemental schedules unless, within such period, further time is granted by the court.

FED. R. BANKR. P. 4003(b).

135 Perkins Coie v. Sadkin (*In re* Sadkin), 36 F.3d 473 (5th Cir. 1994) (per curiam).

136 *Id.* at 477.

137 *Id.* at 475-78.

138 *Id.* at 476-77.

139 11 U.S.C. 522(*l*) (1994).

140 *Sadkin*, 36 F.3d at 477.

141 503 U.S. 638 (1992).

period of Rule 4003(b) has expired, section 522(*l*) "has made the property exempt. [A trustee] cannot contest the exemption at this time whether or not [the debtor] had a colorable statutory basis for claiming it."[142] Obviously, the Supreme Court is more interested in finality than in sorting out on appeal whether a claimed exemption is made in good faith. The Fifth Circuit took this cue and, accordingly, found the Perkins Coie objection to be untimely notwithstanding the merits of the issue.

MORE EQUITABLE SUBORDINATION

In *United States Abatement Corp. v. Mobil Exploration & Producing U.S., Inc.*,[143] Judge King dealt politely, but firmly, with an appeal that is best described as suffering from convoluted logic. The debtor, who had filed a complaint for equitable subordination[144] against Mobil, argued on appeal that the bankruptcy court had erred by deciding the issue at all prior to deciding whether Mobil had a valid claim against the estate.[145] The court found this argument to be without merit and rejected the equitable subordination argument as well.[146]

Judge King reiterated that the law of equitable subordination is well established in the Fifth Circuit.[147] Equitable subordination is a remedial, not penal, measure which is used sparingly. The Fifth Circuit has a three-prong test[148] to determine the application of equitable subordination. The test is confined to three general paradigms:[149] (1) "[w]hen a fiduciary of the debtor misuses his position to the disadvantage of other creditors; (2)

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142 *Id.* at 643-44.

143 United States Abatement Corp. v. Mobil Exploration & Producing U.S., Inc. (*In re* United States Abatement Corp.), 39 F.3d 556 (5th Cir. 1994).

144 The judicially-created doctrine of equitable subordination is codified at 11 U.S.C. § 510(c) (1994).

145 *United States Abatement Corp.*, 39 F.3d at 560.

146 *Id.*

147 *Id.* at 561; *see also* Fabricators, Inc. v. Technical Fabricators, Inc. (*In re* Fabricators, Inc.), 926 F.2d 1458 (5th Cir. 1991); Smith v. Associates Commercial Corp. (*In re* Clark Pipe & Supply Co.), 893 F.2d 693 (5th Cir. 1990); Holt v. FDIC (*In re* CTS Truss, Inc.), 868 F.2d 146 (5th Cir. Cir. 1989); Benjamin v. Diamond (*In re* Mobile Steel Co.), 563 F.2d 692 (5th Cir. 1977).

148 The court stated that: "(1)[t]he claimant must have engaged in some type of inequitable conduct; (2) the conduct must have resulted in injury to the creditors or conferred an unfair advantage on the claimant; and (3) the invocation of equitable subordination must not be inconsistent with the provisions of the Bankruptcy Code." *United States Abatement Corp.*, 39 F.3d at 561.

149 A paradigm is an outstandingly clear or typical example.

when a third party controls the debtor to the disadvantage of other creditors; and (3) when a third party actually defrauds other creditors."[150]

Judge King dismissed the first and third paradigms as inapplicable because (1) there was an absence of facts to establish a fiduciary obligation and (2) no allegations of fraud were asserted. The second paradigm—when a third party controls the debtor to the disadvantage of other creditors —was applied to the facts.[151]

Mobil had refused to pay certain sums due under two contracts with the debtor.[152] Mobil exercised its contractual right of recoupment from the debtor for sums it became obligated to pay to other creditors of the debtor (subcontractors) who had filed liens against its rigs.[153]

The debtor's theory was that Mobil "controlled" it because the non-payment cut off virtually all of its cash flow. Since the debtor's accounts receivable were assigned to a secured creditor, that creditor and the unsecured creditors, who had no lien rights, were disadvantaged. Judge King ironically[154] pointed to *In re Clark Pipe*[155] as precedent for the proposition that absent more, the court will not equitably subordinate a creditor who is exercising its contractual rights. Although Mobil's actions created economic leverage on the debtor by its actions, this does not give Mobil inequitable "control." Accordingly, Mobil's motion to dismiss the equitable subordination complaint was affirmed.[156]

CHAPTER 11 ISSUES

There is nothing remarkable about the set of facts that give rise to the case of *In re Manges v. Seattle-First National Bank*,[157] except that Judge King's undeniable logic,

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150 *United States Abatement Corp.*, 39 F.3d at 561.

151 *Id.* at 561-62.

152 *Id.* at 561.

153 *Id.* at 562.

154 Able counsel for Mobil was also counsel for the losing trustee in *In re* Clark Pipe. *See United States Abatement Corp.*, 39 F. 3d at 564; *In re* Clark Pipe & Supply Co., 893 F.2d at 695.

155 *In re* Clark Pipe & Supply Co., 893 F.2d at 702.

156 *United States Abatement Corp.*, 39 F.3d at 562.

157 Manges v. Seattle-First Nat'l Bank (*In re* Manges), 29 F.3d 1034 (5th Cir. 1994), *cert. denied*, 115 S. Ct. 1105 (1995).

analysis, and clarity have produced yet another case that practitioners can cling to for quite awhile in an area that is subject to much uncertainty and hand wringing.[158]

What does it take to moot an appeal of an order confirming a plan of reorganization? Read this case, and be comforted. The primary creditor, Seattle-First National Bank (Seattle), obtained a confirmation of its liquidating plan. Although the debtor sought a stay pending appeal at every step of the way to the Fifth Circuit, he could obtain no relief. Meanwhile, Seattle continued to negotiate, infuse capital, sell assets, and distribute funds. Even though the district court refused to dismiss the case as moot, by the time it reached Judge King, there was little left to do with the debtor's estate. Consequently, the Fifth Circuit ruled that, given the facts of the case, the plan was substantially consummated,[159] and the appeal was dismissed as moot.

As Judge King noted in describing "substantial consummation," the egg could not be unscrambled. This article is not the appropriate forum to go through the laundry list of events that led to the conclusion that there had been substantial consummation which had the effect of mooting the appeal. As suggested earlier, read the case and be comforted that, except in the rarest of cases during a pendency of appeal where there is no stay,[160] there is sufficient time to take steps that will meet the substantial consummation measure.

What is the lesson to be drawn from this case? Be faint of heart no more. If you can persuade the bankruptcy court to confirm your plan, the likelihood of an objecting party obtaining a stay pending appeal is slim. Even slimmer is the likelihood that an appeal will address the merits once it reaches the Fifth Circuit.

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158 The author, as a student of the Fifth Circuit's work, is an unabashed admirer of Judge King's work.

159 11 U.S.C. § 1101(2) provides:

> "[S]ubstantial consummation" means–
> (A) transfer of all or substantially all of the property proposed by the plan to be transferred;
> (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and
> (C) commencement of distribution under the plan.

11 U.S.C. § 1101(2) (1994).

160 *See* Ronit, Inc. v. Stemson Corp. (*In re* Block Shim Dev.), 939 F.2d 289 (5th Cir. 1991); Halliburton Serv. v. Crystal Oil Co. (*In re* Crystal Oil Co.), 854 F.2d 79 (5th Cir. 1988); Brite v. Sun Country Dev., Inc. (*In re* Sun Country Dev., Inc.), 764 F.2d 406 (5th Cir. 1985).

The *Rash*[161] case may be the most significant bankruptcy case handed down during this survey period. Judge Smith, writing for the panel, addressed a valuation issue in a Chapter 13 case which will have spill-over application to Chapter 11 cases.

At issue was whether the proper measure of value for an undersecured creditor in a Chapter 13 case was the wholesale or retail value. The debtor proposed a plan that called for retention of the collateral (a truck) and a stream of payments based on its wholesale value. The bankruptcy court agreed and used the wholesale value to determine the secured and unsecured portions of the creditor's claim. The district court affirmed. On appeal, the Fifth Circuit reversed, agreeing with the creditor that retail value was the proper measure.

Judge Smith's opinion is a model of clarity and careful analysis. He starts with the proposition set forth in the Bankruptcy Code that a secured creditor must receive the present value of its allowed, secured claim under a Chapter 13 plan.[162] This is the same test for a Chapter 11 cramdown of a secured creditor.[163] There was nothing in the opinion that would suggest that there is a basis for not applying the value measurement in both Chapter 13 and Chapter 11 cases.

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161 Associates Commercial Corp. v. Rash (*In re* Rash), 31 F.3d 325 (5th Cir. 1994), *modified*, 62 F.3d 685 (5th Cir. 1995), *reh'g granted*, No. 93-5396, 1995 WL 613328 (5th Cir. Oct. 18, 1995).

162 11 U.S.C. § 1325(a)(5)(B) provides in part:

> [T]he court shall confirm a plan if —
>
> . . . .
>
> (5) with respect to each allowed secured claim provided for by the plan—
>
> (B)(i) the plan provides that the holder of such claim *retain the lien securing such claim; and*
>
> (ii) *the value,* as of the effective date of the plan, of property to be distributed under the plan on account of such claim *is not less than the allowed amount of such claim;* or
>
> (C) the debtor surrenders the property securing such claim to such holder; 11 U.S.C. § 1325(a)(5)(B) (1994) (emphasis added).

163 11 U.S.C. § 1129(b)(2)(A) provides, in part

> (A) With respect to a class of secured claims, the plan provides—
>
> (i)(I) that the holders of such claims *retain the liens securing such claims* . . . . to the extent of the allowed amount of such claims; and
>
> (II) that such holder of a claim of such class *receive* on account of such claim *deferred cash payments totaling at least the allowed amount of such claim,* of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property.

Id. § 1129(b)(2)(a) (emphasis added).

The court addressed 11 U.S.C. § 506(a), which provides in part:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . . is a secured claim to the extent of the value of such creditor's interest . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property . . . .[164]

The court observed that cases interpreting this section have focused on the first two sentences and, depending on the relative emphasis, have reached one of two results; either wholesale or retain value is used.[165]

Those cases which focus on the first sentence of section 506(a) have adopted the "foreclosure approach."[166] Under this approach, the secured creditor in a Chapter 13 case is entitled to receive the amount it could have obtained if the collateral were foreclosed on.

The second line of cases, which the Fifth Circuit chose to follow, places more emphasis on the second sentence of section 506(a). If the debtor proposes to keep the collateral, those cases find that the purpose of the valuation is to determine the amount an undersecured creditor will be paid on its secured claim. In that instance, the value of the creditor's lien is derived from the stream of payments that the lien secures, rather than the right to foreclose, because the sale of the collateral is not contemplated. This is referred to as the "replacement model." According to this analysis, the replacement value to the debtor is retail rather than wholesale.[167]

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[164] *Id* § 506(a).

[165] *See In re* Green, 151 B.R. 501, 502 (Bankr. D. Minn. 1993).

[166] *See* General Motors Acceptance Corp. v. Mitchell (*In re* Mitchell), 954 F.2d 557 (9th Cir.), *cert denied*, 113 S. Ct. 303 (1992). *But see* Lomas Mortgage USA v. Wiese, 980 F.2d 1279, 1286 (9th Cir. 1992), *vacated on other grounds*, 113 S. Ct. 2925 (1993) *(critizing Mitchell).*

[167] See Coker v. Sovran Equity Mortgage Corp.(*In re* Coker), 973 F.2d 258, 260 (4th Cir. 1992); Brown & Co. Sec. Corp. v. Balbus (*In re* Balbus), 933 F.2d 246, 251-52 (4th Cir. 1991).

The court's preference for the "replacement model," or "retail value," is grounded in the view that this line of cases give effect to all of the language of section 506(a). The "purpose of the valuation" in the second sentence is given no effect by focusing on "foreclosure" value. Moreover, if the debtor retains the collateral, the proper measure of the "estate's interest"[168] in the collateral is a "going concern" value. That value is best measured by what the debtor would have to pay to replace the collateral.

As the court noted, whenever possible, it attempts to preserve the terms of the original agreement between the parties. Because the court believes that the "foreclosure model" has the potential to generate windfalls for the debtor, the choice seemed predetermined.[169] This is a happy result for undersecured creditors, as it will diminish the sting of their secured claim reduction in both Chapter 13 and Chapter 11.

TRUSTEE POWERS

Askanase v. LivingWell, Inc.[170] is an example of some thoughtful planning that was not thoughtful enough. The debtor had created a Directors and Officers Liability Insurance Trust two years before it filed its bankruptcy petition and funded it with $1,000,000 of unencumbered cash. The purpose of the trust was to indemnify the debtor's officers and directors from liability and legal expenses arising out of their position with the corporation.[171]

At issue in the case was the power of the Chapter 7 trustee to amend the trust and liquidate it immediately, leaving the officers and directors a claim against the debtor for failure to indemnify. The language in the trust provided that it could be terminated but: "No termination of this Trust or the insurance coverage provided by the trust shall be effective until at least 36 months after the date on which the resolution of the Board of Directors of the Company authorizing such termination is adopted."[172] No one disputed

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[168] See the first sentence of section 506(a), which reads in part: "the value of such creditor's interest in the *estate's interest* in such property." 11 U.S.C. § 506(a) (1994) (emphasis added).

[169] *See* Butler v. United States, 440 U.S. 48 (1979).

[170] 45 F.3d 103 (5th Cir. 1995) (per curiam).

[171] The debtor owned and operated physical fitness facilities.

[172] *Askanase*, 45 F.3d at 104 (quoting art. VII, § 7.2 of the trust).

the power of the Chapter 7 trustee to terminate the trust. However, the dispute arose when the trustee *amended* the trust to eliminate the above-quoted language and made the termination effective immediately.[173]

Both the bankruptcy court and district court held that the trustee could not amend the trust. The Fifth Circuit reversed by a per curiam decision. First, the court observed that the bankruptcy estate succeeds to "all legal or equitable interests of the debtor in property as of the commencement of the case," including those powers that the debtor may exercise for its own benefits.[174] As the court noted, "[a]ny interest which a debtor retains in a trust is property of the estate, including the power to amend the trust."[175] Obviously, the debtor, in order to avoid amendment by the trustee, should have made the trust or certain provisions not subject to amendment.[176] Failing to do so, the bankruptcy trustee has the powers the debtor could exercise for its own benefit over property, which includes the right to amend and terminate the trust.

Drafting tip for those business attorneys reading this article. As the court noted, it cannot read into a contract that which is not there.[177] If you want to restrict the right to amend, put the language in the trust. Otherwise, your clever planning will not be thoughtful enough, as evidenced by this result.

MISCELLANEOUS

The Unauthorized Practice of Law Committee of the State of Texas (UPLC) sued the Creditors Bankruptcy Service (CBS) for the alleged unauthorized practice of law in *State Unauthorized Practice of Law Committee v. Paul Mason & Associates, Inc.*[178]

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173 The Chapter 7 trustee amended the trust by inserting the following language in § 7.2: "Notwithstanding the foregoing, should this Trust . . . be terminated by its Court-appointed Trustee in bankruptcy, the termination shall be effective immediately." *Id* at 105 n.2.

174 11 U.S.C. § 541(a)(1), (b)(1) (1994).

175 *Askanase*, 45 F.3d at 106; *see also In re* Gifford, 93 B.R. 636, 640 (Bankr. N.D. Ind. 1988).

176 In fact, § 7.1 of the trust left broad powers in the board of directors to amend the trust so long as it did not affect "the rights, duties or responsibilities of the Trustee . . . without its consent." *Askanase*, 45 F. 3d at 107.

177 Southwest E & T Suppliers, Inc. v. American Enka Corp., 463 F.2d 1165, 1166 (5th Cir. 1972).

178 46 F.3d 469 (5th Cir. 1995).

CBS's business is to act as an agent for creditors and administer creditors' non-contingent, liquidated claims against debtors. Typically, CBS files a proof of claim, monitors the case, and, where appropriate, contacts the debtor's counsel to discuss and negotiate reaffirmations. CBS does not handle disputed claims and provides no legal advice to its clients.

The court agreed with CBS that Bankruptcy Rules 9010(a)[179] and 1001[180] authorize CBS's activities. The challenged activities are administrative functions that can be performed by authorized non-lawyer agents without constituting the unauthorized practice of law.

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[179] Bankruptcy Rule 9010(a) provides:

> A debtor, creditor, equity security holder, indenture trustee, committee or other party may (1) appear in a case under the Code and act either in the entity's own behalf or by an attorney authorized to practice in the court, and (2) perform any act not constituting the practice of law, by an authorized agent, attorney in fact, or proxy.

FED. R. BANKR. P. 9010(a).

[180] Bankruptcy Rule 1001 provides in part: "These rules shall be construed to secure the just, speedy, and inexpensive determination of every case and proceeding." *Id.* 1001.