FIFTH CIRCUIT BANKRUPTCY SURVEY

Brad W. Odell†

---

† Associate, Bell Nunnally & Martin L.L.P., Dallas, Texas. J.D., Texas Tech University School of Law; M.B.A., Rawls College of Business, Texas Tech University; B.A., University of Utah. Mr. Odell's practice includes the representation of secured and unsecured creditors in bankruptcy. Prior to joining Bell Nunnally & Martin, Mr. Odell clerked for the Honorable Robert L. Jones, United States Bankruptcy Judge for the Northern District of Texas.

I. INTRODUCTION

This Survey Article reviews ten selected bankruptcy opinions of the United States Court of Appeals for the Fifth Circuit decided between July 1, 2009, and June 30, 2010. During the Survey period, the Fifth Circuit published twenty-five bankruptcy decisions. The selected decisions either deal with issues of first impression or clarifications of Fifth Circuit law.

The selected decisions cover several prominent areas of bankruptcy law including: equitable mootness, projected disposable income, and the absolute priority rule. Other topics this Survey article covers include a debtor's right to dismiss its case, standing to seek damages for a violation of the automatic stay, and issues arising in Chapter 15 of the Bankruptcy Code.

II. VOLUNTARY DISMISSAL: A DEBTOR'S RIGHT TO VOLUNTARILY DISMISS A BANKRUPTCY CASE UNDER § 1307 IS SUBJECT TO AN EXCEPTION FOR BAD FAITH (*IN RE JACOBSEN*)

In *In re Jacobsen*, the Fifth Circuit, as an issue of first impression, determined whether § 1307(b) gave a debtor the absolute right to dismiss a Chapter 13 bankruptcy case or whether there was a bad-faith exception to a debtor's right to dismiss.[1] Section 1307(b) provides that "[o]n request of the debtor at any time, if the case has not been converted under [sections] 706, 1112, or 1208 of this title, the court shall dismiss a case under this chapter. Any waiver of the right to dismiss under this subsection is unenforceable."[2] As part of the Fifth Circuit's analysis, the court looked to the approach taken by other courts, the Supreme Court's decision in *Marrama v. Citizens Bank of Massachusetts*, and decisions of other courts made after *Marrama*.[3]

The Fifth Circuit recognized that there was a circuit split as to whether a bad-faith exception applied to a debtor's right to dismiss its Chapter 13 case.[4] In *Nash v. Kester*, the Ninth Circuit suggested in dicta that a debtor's right to dismiss was absolute, reasoning that the plain language of the statute did not allow for an exception to § 1307(b).[5] Other lower courts, including the Ninth Circuit Bankruptcy Appellate Panel, took the same approach.[6] Other courts, however, were of another opinion and held that § 1307(b) was subject to an exception for the debtor's bad faith or abuse of

1. *See* Jacobsen v. Moser (*In re* Jacobsen), 609 F.3d 647, 652 (5th Cir. June 2010).
2. *Id.* at 653 (quoting 11 U.S.C. § 1307(b) (2006)).
3. *See id.* at 653-61 (discussing Marrama v. Citizens Bank of Mass., 549 U.S. 365 (2007)).
4. *See id.* at 653-55.
5. *Id.* at 653 (citing Nash v. Kester (*In re* Nash), 765 F.2d 1410, 1413 (9th Cir. 1985)).
6. *See id.*

the bankruptcy process.[7] These courts included the Eighth Circuit and the district court from the Northern District of Texas.[8] After the Eighth Circuit held that an exception applies, the Second Circuit came out with an opinion holding that no exception applied.[9] The Second Circuit held that "the mandatory terms of § 1307(b) were reinforced by the principle that Chapter 13 bankruptcy is intended to be purely voluntary."[10]

The Supreme Court then handed down its opinion in *Marrama*.[11] *Marrama* dealt with a different, but similar issue.[12] *Marrama* involved a debtor who inaccurately listed all of his assets, listing a trust with zero value when the trust held a home with substantial value.[13] The trustee decided to recover the house that the debtor transferred to the trust within the last year.[14] In an attempt to prevent the trustee from recovering the house, the debtor filed a motion to convert his case to one under Chapter 13.[15] Similar to § 1307(b), § 706(a) provides that the debtor may convert his case to another title so long as the case has not been previously converted.[16] The Supreme Court looked to § 706(d) and held that to be able to convert its case, the debtor must be eligible to be a debtor under the chapter to which conversion is sought.[17] The Court went on to hold that because of the debtor's bad faith, he was not eligible to be a debtor under Chapter 13, preventing him from converting his case to Chapter 13.[18] Since *Marrama*, courts remain divided as to whether a bad-faith exception applies to § 1307(b).[19]

Based on the Supreme Court's analysis, the Fifth Circuit held that *Marrama*'s analysis applies and the court has discretion to grant conversion of a case from Chapter 13 to Chapter 7 over a debtor's motion to dismiss when the "debtor has acted in bad faith or abused the bankruptcy process."[20] The Fifth Circuit also held that, based on § 105 of the Bankruptcy Code and the court's inherent power, a court has power to negate a debtor's apparent absolute right to dismiss its bankruptcy case.[21]

---

7. *Id.*
8. *See id.* at 653-54 (citing Molitor v. Eidson (*In re* Molitor), 76 F.3d 218 (8th Cir. 1996); Foster v. N. Tex. Prod. Credit Assoc., 121 B.R. 961 (N.D. Tex. 1990)).
9. *See id.* at 653-55.
10. *Id.* at 655 (citing Barbieri v. RAJ Acquisition Corp. (*In re* Barbieri), 199 F.3d 616, 620 (2d Cir. 1999)).
11. *See id.* (citing Marrama v. Citizens Bank of Mass., 549 U.S. 365 (2007)).
12. *See id.*
13. *Id.*
14. *See id.*
15. *See id.*
16. *See id.*
17. *Id.* at 656.
18. *See id.*
19. *See id.* at 657-60.
20. *Id.* at 660.
21. *Id.* at 661.

Applying this new standard to the facts before it, the Fifth Circuit held that it was not an abuse of discretion for the bankruptcy court to grant the trustee's motion to convert over debtor's motion to dismiss.[22] Jacobsen had failed to disclose several properties on his schedules and statement of financial affairs, claiming that he did not believe he needed to because they were titled in his wife's name.[23] Further, Jacobsen failed to disclose many of his business transactions, including several investments he made overseas.[24] The Fifth Circuit held, based on the record, it was not an abuse of discretion to find that Jacobsen acted in bad faith by failing to disclose all of his property on his schedules and failing to disclose transfers made on his statement of financial affairs.[25]

III. PROJECTED DISPOSABLE INCOME: PRESENT OR REASONABLY CERTAIN FUTURE CHANGES OF CIRCUMSTANCES INCLUDED IN CALCULATION (*IN RE NOWLIN*)

In *In re Nowlin*, the Fifth Circuit took on the task of determining whether "projected disposable income" included future events or circumstances that affected the debtor's income or expenses.[26] According to the debtor's schedules and Form B22C, the debtor's monthly disposable income was $38.67, resulting in a payment of $2,320.20 to unsecured creditors.[27] The debtor proposed a plan that would pay $195.00 per month to creditors, resulting in a total payment of $1,814.19 to unsecured creditors.[28] The debtor later amended her plan, modifying the amount of the I.R.S. priority claim.[29] The modification resulted in a reduction of the total amount paid over the plan to unsecured creditors to $980.45.[30] The Chapter 13 trustee objected to the debtor's modified plan, and at the hearing, the debtor testified that she would repay the loan from her 401(k) plan within two years, freeing up an additional $1,134.79 a month.[31] The trustee argued that known future events should be considered in calculating the debtor's projected disposable income; whereas, the debtor argued that projected disposable income is a mechanical test, which should not deviate from § 1325(b).[32]

---

22. *Id.* at 662-63.
23. *Id.* at 651. Jacobsen's wife did not file for bankruptcy protection. *Id.* at 649.
24. *Id.* at 651.
25. *Id.* at 662-63.
26. Nowlin v. Peake (*In re* Nowlin), 576 F.3d 258, 260 (5th Cir. July 2009).
27. *Id.*
28. *Id.*
29. *Id.* at 261.
30. *Id.*
31. *Id.*
32. *Id.*

The Fifth Circuit adopted the trustee's argument, holding that projected disposable income should take into account present or reasonably certain changes of circumstances to a debtor's income or expenses.[33] The Fifth Circuit reasoned that the term "projected" adds to the phrase's overall meaning.[34] Because "projected" modifies "disposable income," the Fifth Circuit held that the calculation is forward-looking.[35] The Fifth Circuit held that this interpretation does not fly in the face of the plain language of the statute because "the statute speaks of 'the debtor's projected disposable income *to be received in the applicable commitment period.*' This language links 'projected disposable income' with the debtor's income actually received during the plan, and indicates a forward-looking orientation of the phrase."[36] Based on this interpretation, the Fifth Circuit held that § 1325(b)(2) creates a presumption that projected disposable income is the same as the calculation for disposable income.[37] But, the presumption can be rebutted by a party-in-interest with evidence that "present or reasonably certain future events" should be taken into account to accurately reflect the debtor's finances going forward.[38] If the future events are not reasonably certain, then they should not be accounted for in the calculation of projected disposable income, and modification of the plan is the appropriate way to deal with them if they occur.[39]

IV. CLASS CERTIFICATION: A BANKRUPTCY COURT HAS AUTHORITY TO CERTIFY A CLASS (*IN RE WILBORN*)

In *In re Wilborn*, the Fifth Circuit decided that bankruptcy courts have the authority to certify a class of plaintiffs and that the same requirements for class certification under Rule 23 of the Federal Rules of Civil Procedure apply.[40] Looking to the Federal Rules of Bankruptcy Procedure, the Fifth Circuit held that "class action proceedings are expressly allowed in the Federal Bankruptcy Rules, which provide that the requirements of class actions under Federal Rule of Civil Procedure 23 apply in adversary proceedings."[41] The Fifth Circuit reasoned that if a bankruptcy court were not permitted jurisdiction over a class action of debtors, then Rule 7023 is virtually read out of the rules.[42] The court also noted that:

---

33. *Id.* at 266.
34. *Id.* at 263.
35. *Id.*
36. *Id.* (emphasis in the original).
37. *Id.* at 266.
38. *Id.*
39. *Id.* at 267.
40. Wilborn v. Wells Fargo Bank, N.A. (*In re* Wilborn), 609 F.3d 748, 751 (5th Cir. June 2010).
41. *Id.* at 754 (citing FED. R. BANKR. P. 7023).
42. *Id.*

> Class actions promote efficiency and economy in litigation and permit multiple parties to litigate claims that otherwise might be uneconomical to pursue individually. These principles are no less compelling in the bankruptcy context. We hold therefore that the bankruptcy court has authority to certify a class action of debtors whose petitions are filed within its judicial district provided that the prerequisites for a class under Rule 23 are satisfied.[43]

The Fifth Circuit then analyzed whether class certification was proper in this case.[44]

Rule 23(a) sets forth four requirements for class certification: numerosity, commonality, typicality, and adequacy of representation.[45] Further, Rule 23(b)(3) "requires the court to find that questions of law or fact common to class members predominate over any questions affecting only individual class members."[46] Additionally, the court must find that a class action is the superior method of adjudicating the issues.[47]

Here, the class of debtors was a group of individuals who had home mortgage loans with or serviced by Wells Fargo.[48] The individuals all filed for Chapter 13 bankruptcy between November 16, 2002, and November 16, 2007.[49] Also, to be a part of the class, Wells Fargo had to have charged, or charged and collected, fees for professional services or costs during the pendency of the debtors' bankruptcy cases—fees which were never disclosed or approved by the bankruptcy court.[50] The class was comprised of approximately 1,236 members who filed Chapter 13 bankruptcy in the Southern District of Texas, though not before the same judge.[51] The fees charged ranged from $1,200 to more than $4,000.[52] In some cases, the court previously approved a portion of the fees.[53]

In the end, while the Fifth Circuit held that a bankruptcy court has the authority to certify a class of debtors, class certification under these facts was improper.[54] The Fifth Circuit determined that damages were not common to all class members and that it would require individual hearings to determine the amount of damages each class member was entitled to.[55]

---

43. *Id.* (internal citation omitted).
44. *See id.* at 755-57.
45. *Id.* at 755 (citing FED. R. CIV. P. 23(a)).
46. *Id.* (quoting FED. R. CIV. P. 23(b)).
47. *Id.*
48. *Id.* at 751.
49. *Id.*
50. *Id.*
51. *Id.*
52. *Id.*
53. *Id.*
54. *Id.* at 754, 757.
55. *Id.* at 756-57.

V. BIFURCATION OF CLAIMS: HANGING PARAGRAPH PREVENTS BIFURCATION OF SECURED CLAIM OF PMSI DEBT THAT INCLUDES NEGATIVE EQUITY, GAP INSURANCE, AND EXTENDED WARRANTIES (*IN RE DALE*)

In *In re Dale*, the Fifth Circuit held that the hanging paragraph of § 1325(a) prevents a bankruptcy court from bifurcating a secured claim into secured and unsecured portions when the secured claim arises from a purchase money security interest (PMSI) even though portions of the debt are attributable to negative equity, gap insurance, and an extended warranty.[56] Dale, the debtor, purchased a new F150 pick-up truck.[57] The debtor used the truck for her personal use, and the truck had a sticker price of $38,291.42.[58] As part of the transaction, the debtor traded in a 2003 Ford Expedition with negative equity of $4,760.[59] The debtor also purchased gap insurance and an extended warranty for the truck.[60] After adding the sticker price, the negative equity, gap insurance, extended warranty, and tax, title, and license, the debtor financed with Ford Motor Credit Company (Ford) $48,271.02.[61] Ford held a PMSI in the truck for the entire amount financed.[62]

Less than one year later, the debtor filed for Chapter 13 relief.[63] At the time of the debtor's filing, she still owed about $41,834.94 to Ford for the truck.[64] As part of the debtor's plan, the debtor sought to pay Ford $23,900 with interest, representing the secured portion of Ford's claim and the remainder pro rata with the unsecured creditors.[65] Ford objected to the plan.[66] The bankruptcy court rejected Dale's plan and sustained Ford's objection in part, finding that Ford had a secured claim for the full amount of its claim less the amounts attributable to the financed negative equity, the gap insurance, and the extended warranty.[67] The district court reversed, holding that Ford held a PMSI for the entire amount of its claim.[68] The

56. Ford Motor Credit Co. v. Dale (*In re* Dale), 582 F.3d 568, 570 (5th Cir. Sept. 2009). The "hanging paragraph" refers to the portion of § 1325(a) that is not numbered. *See* 26 U.S.C. § 1325(a) (2006).

57. *In re Dale*, 582 F.3d at 570.

58. *Id.*

59. *Id.* at 570-71.

60. *Id.* at 571.

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.*

66. *Id.*

67. *See id.*

68. *Id.*

Fifth Circuit affirmed the district court's decision, holding that the hanging paragraph of § 1325(a) prevents bifurcation of a PMSI.[69]

As part of its analysis, the Fifth Circuit recognized that bankruptcy courts across the country have been divided on the issue.[70] The Fifth Circuit, however, noted that three recent circuit court opinions and a state's highest court on certified question ruled that the hanging paragraph prevents bifurcation of a PMSI on vehicle loans, including portions representing negative equity.[71] In determining whether those portions of a PMSI attributable to negative equity, gap insurance, and extended warranties can be crammed down, the Fifth Circuit found the plain language of the hanging paragraph to be insufficient.[72] As such, the Fifth Circuit turned to the Uniform Commercial Code (UCC) to determine under state law the scope of a PMSI.[73] Looking to Texas law, the Fifth Circuit defined a PMSI in goods as a security interest in goods that are "purchase-money collateral."[74] In turn, "purchase-money collateral" is defined as goods that secure a "purchase-money obligation."[75] Finally, the Fifth Circuit defined "purchase-money obligation" as "'an obligation . . . incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.'"[76]

Using these UCC definitions, the Fifth Circuit concluded that "price" and "value given to enable" supported the conclusion that a PMSI includes amounts attributable to negative equity, gap insurance, and extended warranties.[77] The Fifth Circuit reasoned that the debtor could not have acquired the right to the truck without financing her negative equity from her trade-in vehicle.[78] As such, the Fifth Circuit affirmed the district court and held that Ford had a PMSI in the entire amount financed, which could not be bifurcated according to the hanging paragraph.[79]

69. *Id.* at 575.
70. *Id.* at 571.
71. *Id.* (citing *In re* Graupner, 537 F.3d 1295, 1300 (11th Cir. 2008) (comparing cases)).
72. *See id.* at 573.
73. *Id.*
74. *Id.*
75. *Id.*
76. *Id.* (quoting TEX. BUS. & COM. CODE ANN. § 9.103 (West 2002)).
77. *See id.* at 574.
78. *See id.* at 575.
79. *Id.*

VI. SETTLEMENT OF CLAIMS: SETTLEMENT OF AVOIDANCE ACTIONS CAN REQUIRE SCRUTINY UNDER § 363 OF THE BANKRUPTCY CODE (*IN RE MOORE*)

In *In re Moore*, the Fifth Circuit held that it was an abuse of discretion for the bankruptcy court not to consider the overbid of the largest creditor of the estate when approving settlement of estate litigation.[80] The Fifth Circuit also held that the bankruptcy court's decision that the trustee's avoidance actions could not be sold was an error of law.[81]

Prior to filing bankruptcy, Moore's largest creditor filed a state court lawsuit seeking to recover on a judgment it owned against Moore.[82] The judgment was worth about $12.5 million.[83] The lawsuit named Moore, Moore's wife, and two entities affiliated with Moore.[84] The creditor alleged that Moore used the business entities to hide his personal assets from his creditors.[85] The creditor sought to get to the assets of the entities through reverse veil-piercing and state law fraudulent conveyances theories.[86] The creditor also sought a constructive trust remedy on all those assets fraudulently transferred.[87] The parties had filed motions for summary judgment in the state court litigation when Moore filed for bankruptcy, staying the litigation.[88]

The Chapter 7 trustee inherited the litigation and retained the creditor's state court litigation counsel to pursue the causes of action in bankruptcy.[89] Because Moore's bankruptcy estate did not have assets to liquidate and distribute, the only potential means of recovery for creditors was asset recovery litigation.[90] As such, the trustee continued to pursue the state court litigation in bankruptcy.[91] The creditor continued to be involved in the trustee's litigation—funding counsel's fees.[92] Eventually, the creditor offered to purchase the litigation from the trustee for $10,000.[93] The trustee countered with his own offer of $150,000 in cash, a 10% kicker in any gross recovery, and waiver of the creditor's claim.[94] The creditor rejected the trustee's counteroffer, but continued to negotiate the purchase of the

80. Cadle Co. v. Mims (*In re* Moore), 608 F.3d 253, 266 (5th Cir. June 2010).
81. *Id.*
82. *Id.* at 255.
83. *Id.* at 256.
84. *Id.* at 255.
85. *Id.*
86. *Id.*
87. *Id.*
88. *Id.* at 256.
89. *Id.*
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*

litigation.[95] The creditor asked the trustee to sell the litigation for $15,000 or auction the litigation to the highest bidder.[96] The trustee refused, and the creditor raised his offer to $30,000.[97] While all this was going on, the bankruptcy court ruled on the summary judgment motion.[98] The bankruptcy court denied defendants' motion, but expressed extreme reluctance to the theories of recovery relied upon by the trustee.[99]

With the summary judgment motion denied, the case was headed toward trial until the creditor and the trustee got crosswise and the creditor stopped funding the litigation.[100] The trustee, without the knowledge of the creditor, began to negotiate a settlement with Moore and the other defendants, eventually reaching a settlement agreement for $37,500.[101] The trustee filed a motion to approve the settlement, and the creditor, learning of the settlement by the motion, filed an objection and contacted the trustee and offered $50,000 to purchase the litigation.[102] At the hearing to approve, the creditor argued that the trustee could not settle the claims when it offered more money to purchase the litigation.[103] The bankruptcy court expressed skepticism as to the trustee's ability to sell avoidance-type causes of action.[104] At a second hearing on the motion to approve settlement, the creditor again argued that the settlement should not be approved because it had offered to purchase the litigation for more money.[105] Again expressing skepticism as to the trustee's ability to sell the avoidance actions, the bankruptcy court approved the settlement over the creditor's objection and higher bid.[106] The district court affirmed.[107]

As an initial matter, the Fifth Circuit analyzed whether the bankruptcy court was correct in its opinion that avoidance actions could not be sold.[108] The Fifth Circuit began its analysis by first determining that § 363 of the Bankruptcy Code allows for the trustee to sell estate property and that litigation claims belonging to the estate can be sold.[109] Next, the Fifth Circuit looked to each individual cause of action to determine whether it was property of the estate.[110] Looking to prior Fifth Circuit precedent,

95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.*
101. *Id.*
102. *Id.*
103. *Id.*
104. *Id.* at 257.
105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.*
109. *Id.* at 257-58.
110. *Id.* at 258-63.

including *S.I. Acquisition*,[111] *MortgageAmerica*,[112] and *Educators*,[113] the Fifth Circuit concluded that the state court litigation claims could be sold by the trustee.[114]

Next, the Fifth Circuit had to decide whether a trustee's compromise of estate litigation constituted a proposed sale of assets, triggering the scrutiny of § 363 sale provisions.[115] Comparing the two standards, the Fifth Circuit noted that to approve a compromise, the settlement must be "fair and equitable" and in the best interests of the estate; whereas, to approve a sale, the sale price typically must be the highest and best offer.[116] Adopting a Bankruptcy Appellate Panel decision out of the Ninth Circuit,[117] the Fifth Circuit held that the proposed settlement was a disposition of estate property and the creditor's higher offer required "the bankruptcy court to consider whether an auction and § 363 sale were appropriate."[118] The Fifth Circuit held that it was up to the discretion of the court to determine whether formal sale procedures were appropriate, remanding the case back to the bankruptcy court to make this determination.[119]

VII. CHAPTER 15: DETERMINATION OF DEBTOR'S "CENTER OF MAIN INTEREST" OR DEBTOR'S ESTABLISHMENT (*IN RE RAN*)

In a matter of first impression, the Fifth Circuit had to determine whether an Israeli bankruptcy receiver had properly filed a petition for relief under Chapter 15 of the Bankruptcy Code.[120] Lavie was appointed as the receiver of the bankruptcy estate of Ran pending in Israel.[121] Ran was a well-known businessman in Israel that experienced financial difficulties in the late 1990s.[122] One of the companies that Ran co-founded and acted as CEO in was placed into liquidation, and its receiver asserted claims against Ran for millions of dollars.[123] Later, an involuntary bankruptcy proceeding was initiated against Ran.[124] Prior to the commencement of the bankruptcy

111. S.I. Acquisition, Inc. v. Eastway Delivery Serv., Inc. (*In re* S.I. Acquisition, Inc.), 817 F.2d 1142 (5th Cir. 1987).

112. Am. Nat'l Bank v. MortgageAmerica Corp. (*In re* MortgageAmerica Corp.), 714 F.2d 1266 (5th Cir. 1983).

113. Schertz-Cibolo-Universal City Indep. Sch. Dist. v. Wright (*In re* Educators Group Health Trust), 25 F.3d 1281 (5th Cir. 1994).

114. *Moore*, 608 F.3d at 262.

115. *Id.* at 263.

116. *Id.*

117. Goodwin v. Mickey Thompson Entm't Grp., Inc. (*In re* Mickey Thompson Entm't Grp., Inc.), 292 B.R. 415 (9th Cir. B.A.P. 2003).

118. *Moore*, 608 F.3d at 265.

119. *Id.* at 266.

120. Lavie v. Ran (*In re* Ran), 607 F.3d 1017, 1019 (5th Cir. May 2010).

121. *Id.*

122. *Id.*

123. *Id.*

124. *Id.*

proceedings in Israel, Ran moved with his family to the Houston area and has never returned to Israel.[125] Ran and his wife own a home in Houston, both are employees of a furniture company, and Ran's wife and five children are U.S. citizens.[126] Ran is a legal permanent resident and has applied for U.S. citizenship.[127] Ran and his family had continuously resided in Houston for over a decade prior to Lavie filing a petition seeking recognition of the Israeli bankruptcy proceeding as a foreign main or nonmain proceeding under Chapter 15 of the Bankruptcy Code.[128]

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) enacted Chapter 15 of the Bankruptcy Code, incorporating the Model Law on Cross-Border Insolvency drafted by UNCITRAL, the United Nations Commission on International Trade Law.[129] The purpose of these amendments was to allow for easier liquidation and reorganization proceedings throughout the world.[130] To gain recognition as a foreign proceeding within Chapter 15, the following prerequisites must be met: (1) the foreign proceeding is a foreign main proceeding or foreign nonmain proceeding pursuant to § 1502; (2) the foreign representative applying for recognition is a person or body; and (3) the petition meets the requirements of § 1515.[131] The Fifth Circuit held that Lavie met the second and third requirements of § 1517(a).[132] Thus, the issue before the Fifth Circuit was whether the foreign proceeding was a foreign main proceeding or a foreign nonmain proceeding.[133]

In analyzing whether the foreign proceeding qualified as a foreign main proceeding, the Fifth Circuit looked to the statutory definitions of foreign main proceeding.[134] Section 1502(4) defines a foreign main proceeding as "a foreign proceeding pending in the country where the debtor has the *center of its main interest.*"[135] While the Bankruptcy Code does not define "center of main interest," it is presumed that the debtor's registered office, or habitual residence in the case of an individual, is his center of main interest.[136] The Fifth Circuit went on to define a debtor's habitual residence as the United States' concept of domicile.[137] To be a debtor's domicile, the debtor must have a physical presence in the location,

125. *Id.*
126. *Id.* at 1020.
127. *Id.*
128. *Id.*
129. *Id.*
130. *See id.* at 1021.
131. *Id.* (citing 11 U.S.C. § 1517(a) (2006)).
132. *Id.* at 1022.
133. *Id.*
134. *Id.*
135. *Id.* (quoting 11 U.S.C. § 1502(4)) (emphasis in the original).
136. *Id.*
137. *Id.*

coupled with an intent to remain there indefinitely.[138] To make this determination, the Fifth Circuit noted a few factors to consider: "(1) the length of time spent in the location; (2) the occupational or familial ties to the area; and (3) the location of the individual's regular activities, jobs, assets, investments, clubs, unions, and institutions of which he is a member."[139] Based on this, the Fifth Circuit held that Ran's domicile and presumed center of main interests was the United States and not Israel.[140]

Of course, this is just a presumption, and the foreign representative can rebut the presumption by evidence to the contrary.[141] To overcome the presumption, the foreign representative must prove by a preponderance of the evidence that the debtor's center of main interests is elsewhere.[142] When an individual's center of main interests is disputed, the Fifth Circuit articulated another set of factors to determine which location is truly the debtor's center of main interests: "(1) the location of a debtor's primary assets; (2) the location of the majority of the debtor's creditors; and (3) the jurisdiction whose law would apply to most disputes."[143] After considering these factors, the Fifth Circuit held that Lavie failed to overcome the presumption that Ran's center of main interests was the United States.[144]

Next, the Fifth Circuit determined whether the foreign proceeding constituted a foreign nonmain proceeding.[145] A foreign nonmain proceeding is a foreign proceeding pending in a country where the debtor has an establishment.[146] Establishment is defined as "*any place of operations* where the debtor carries out a *nontransitory economic activity*."[147] To determine what is meant by "any place of operations" and "carries out a nontransitory economic activity," the Fifth Circuit looked to the drafters of the Model Law for Cross-Border Insolvency for guidance.[148] European Union legislative history indicated that "place of operations" means "a place from which economic activities are exercised on the market (i.e. externally), whether the said activities are commercial, industrial or professional" at the time of the Chapter 15 petition.[149] The mere presence of assets in a location alone does not constitute a place of operations.[150] Based on the legislative history and the Bankruptcy Code definitions, the

138. *Id.*
139. *Id.* at 1022-23 (citations omitted).
140. *Id.* at 1023.
141. *See id.*
142. *Id.*
143. *Id.* at 1024 (citations omitted).
144. *Id.* at 1026.
145. *Id.* at 1026-28.
146. *Id.* at 1026.
147. *Id.* (quoting 11 U.S.C. § 1502(2) (2006)) (emphasis in the original).
148. *Id.* at 1027.
149. *Id.* (quoting Council Report on the Convention on Insolvency Proceedings, at 49, No. 6500/96).
150. *Id.*

Fifth Circuit held that Ran did not have an establishment in Israel.[151] Thus, the Fifth Circuit affirmed the district court's denial of Lavie's petition under Chapter 15.[152]

VIII. CHAPTER 15: AVOIDANCE RELIEF AVAILABLE UNDER FOREIGN LAW (*IN RE CONDOR INSURANCE LTD.*)

In *In re Condor Insurance Ltd.*, the Fifth Circuit determined whether a foreign representative could bring avoidance actions under foreign law in a Chapter 15 case.[153] In this case, Condor Insurance Ltd., a Nevis corporation, was placed in winding up procedures in Nevis.[154] Richard Fogerty and William Tacon were appointed joint official liquidators of the winding up proceeding.[155] As joint official liquidators, Fogerty and Tacon filed a petition under Chapter 15 of the Bankruptcy Code in Mississippi.[156] Fogerty and Tacon alleged that Condor Insurance Ltd. transferred over $313 million in assets to Condor Guaranty, Inc. to put them out of the reach of Nevis creditors.[157] Once the bankruptcy court recognized the winding up proceeding as a foreign main proceeding, the foreign representatives filed an adversary proceeding alleging avoidance claims under Nevis law to recover the transferred assets.[158] Condor Guaranty, Inc. filed a motion to dismiss, arguing that avoidance actions in ancillary proceedings are only available under Chapter 7 or 11 proceedings.[159] The bankruptcy court dismissed the adversary proceeding, and the district court affirmed.[160]

In determining whether a foreign representative can bring avoidance actions under foreign law in a Chapter 15 case, the Fifth Circuit looked to Chapter 15's provisions and the Model Law on Cross-Border Insolvency.[161] Section 1521(a) provides that upon the recognition of a foreign main or nonmain proceeding, the court may, upon request, grant any of the following relief to protect the assets of the debtor or the interests of the creditors: (1) staying actions against the debtor's assets; (2) staying execution against the debtor's assets; (3) suspending the debtor's rights to transfer, encumber, or otherwise dispose of its assets; (4) acquiring information, evidence, or examination of witnesses regarding the debtor's

151. *Id.* at 1028.
152. *Id.*
153. Fogerty v. Petroquest Res., Inc. (*In re* Condor Ins., Ltd.), 601 F.3d 319, 320 (5th Cir. Mar. 2010).
154. *Id.* at 320. Nevis is a small island in the Caribbean Sea. *See* THE ENCHANTING ISLAND OF NEVIS, http://www.nevisisland.com/default.htm (last visited Apr. 20, 2011).
155. *In re Condor Ins., Ltd.*, 601 F.3d at 320.
156. *Id.*
157. *Id.*
158. *Id.* at 321.
159. *Id.*
160. *Id.*
161. *Id.*

assets and affairs; (5) entrusting the assets of the debtor to the foreign representative or another person; (6) extending the relief granted under § 1519(a); and (7) granting relief available to a trustee, except for relief under §§ 522, 544, 545, 547, 548, 550, and 724(a).[162] Based on § 1521(a)(7), the Fifth Circuit had to determine whether the paragraph excepted all avoidance actions or only United States' law avoidance actions.[163] Applying a canon of statutory construction, the Fifth Circuit held that "where there are enumerated exceptions 'additional exceptions are not to be implied, in the absence of a contrary legislative intent.'"[164] Further, the Fifth Circuit looked to the policy behind the adoption of the Model Law on Cross-Border Insolvency and held that the purpose was to facilitate the cooperation of foreign jurisdictions in insolvency proceedings.[165] Based on the Fifth Circuit's analysis and interpretation of both the Bankruptcy Code and the Model Law on Cross-Border Insolvency, the Fifth Circuit held that a foreign representative can bring avoidance actions based on foreign law in an ancillary proceeding.[166]

IX. VIOLATION OF AUTOMATIC STAY: A CREDITOR HAS STANDING TO SEEK DAMAGES FOR VIOLATION OF THE AUTOMATIC STAY (*ST. PAUL FIRE & MARINE INSURANCE CO. V. LABUZAN*)

In a matter of first impression for the court, the Fifth Circuit determined whether a creditor of the bankruptcy debtors had standing to seek damages based on another party's violation of the automatic stay.[167] In *St. Paul Fire & Marine Ins., Co. v. Labuzan*, Contractor Technology, Ltd. filed for Chapter 11 bankruptcy protection.[168] "The Labuzans owned 99 percent of the limited, and 100 percent of the general, partnership interest in Contractor Technology."[169] St. Paul Fire & Marine Insurance Company insured, through payment and performance bonds, several projects for Contractor Technology, and as part of that insurance, the Labuzans had personal indemnity agreements with St. Paul.[170] Once Contractor Technology filed for bankruptcy, St. Paul contacted project owners, in alleged violation of the automatic stay, informing the owners that Contractor Technology was in bankruptcy and that St. Paul would reduce its liability to the owners for any payments made by the owners to

162. *Id.* at 323 n.18.
163. *Id.* at 323.
164. *Id.* at 324 (citation omitted).
165. *Id.*
166. *Id.* at 329.
167. St. Paul Fire & Marine Ins. Co. v. Labuzan, 579 F.3d 533, 536 (5th Cir. Aug. 2009).
168. *Id.*
169. *Id.*
170. *Id.*

Contractor Technology.[171] After these alleged communications, Contractor Technology experienced reduced revenues and had to convert its case to Chapter 7.[172] St. Paul had to pay over $32 million on its payment bonds with Contractor Technology.[173] St. Paul then sued the Labuzans for breach of their indemnity agreements.[174] The Labuzans raised affirmative defenses to St. Paul's claims, including that St. Paul violated the automatic stay, and sought damages for the alleged violation.[175] Later, Contractor Technology's bankruptcy trustee and the Labuzans filed an adversary proceeding in Contractor Technology's bankruptcy case against St. Paul for damages due to St. Paul's violation of the automatic stay.[176] St. Paul's district court lawsuit and the bankruptcy adversary proceeding were consolidated, and the district court granted St. Paul's summary judgment motion in part, leaving the Labuzans' defense for violation of the stay.[177] After the district court granted in part St. Paul's motion for summary judgment, the trustee and St. Paul settled the claims.[178] St. Paul then raised before the district court the Labuzans' standing to pursue the damages claim under § 362(k).[179] The district court found that the Labuzans lacked standing to recover damages and entered judgment against them for $32 million.[180]

In determining whether a creditor has standing to assert a damages claim for violation of the automatic stay, the Fifth Circuit considered both the constitutional and prudential requirements of standing.[181] Looking to the constitutional requirements—injury in fact, actions traceable to the defendant, and capable of redress by a favorable decision—the Fifth Circuit held that the Labuzans met the constitutional requirements of standing.[182] The Fifth Circuit held that the Labuzans' injuries for Contractor Technology's failure to reorganize were easily traceable to St. Paul's alleged stay violations and these injuries are likely to be redressed by a favorable decision.[183]

Turning to the prudential requirements of standing, the Fifth Circuit had to determine whether the Labuzans' claims fell within the zone of interests protected by § 362(k), whether the Labuzans' claims were generalized grievances better addressed by the legislature, and whether the

171. *Id.*
172. *Id.*
173. *Id.*
174. *Id.*
175. *Id.*
176. *Id.* at 537.
177. *Id.*
178. *Id.*
179. *Id.*
180. *Id.* at 538.
181. *Id.* at 538-39.
182. *Id.* at 539.
183. *Id.*

Labuzans' were asserting their own legal rights as opposed to those of a third party.[184] With regard to the first prudential requirement, the Fifth Circuit held that § 362(k) provides that an individual injured by a stay violation can seek recovery of damages.[185] While individual is not defined, the Fifth Circuit held that it included both debtors and non-debtors throughout the Bankruptcy Code.[186] The Fifth Circuit went on to look at the legislative intent of § 362(k) and other case law, finding that both provided for creditor standing.[187] In the end, the Fifth Circuit held that creditors were within the zone of interests protected by § 362(k), meeting the first requirement of prudential standing.[188]

The Fifth Circuit went on to analyze the remaining two prudential considerations.[189] Based on its holding regarding the first prudential requirement, the Fifth Circuit held that the second requirement, whether the Labuzans raised general grievances, was adequately met.[190] Finally, the Fifth Circuit considered whether the Labuzans were bringing their own legal interests or those of Contractor Technology.[191] After looking at prior Fifth Circuit case law determining whether particular causes of action belong to the bankruptcy estate, the Fifth Circuit held that a claim for violation of the automatic stay brought by someone other than the trustee is not property of the estate.[192] The Fifth Circuit went on to say that a debtor and creditor may have similar claims for another party's violation of the automatic stay, but those claims are not mutually exclusive.[193] As such, the Fifth Circuit held that to the extent that the Labuzans allege damages for St. Paul's stay violation, other than for damages as shareholders of Contractor Technology, the Labuzans have standing to seek damages under § 362(k).[194]

X. EQUITABLE MOOTNESS: EQUITABLE MOOTNESS IS A PRUDENTIAL LIMITATION NOT A JURISDICTIONAL LIMITATION (*IN RE BLAST ENERGY SERVICES, INC.*)

In *In re Blast Services, Inc.*, the Fifth Circuit further elaborated on the appellate doctrine of equitable mootness in Chapter 11 cases.[195] In the Fifth

184. *Id.*
185. *Id.*
186. *Id.* at 540.
187. *Id.* at 543.
188. *Id.*
189. *Id.* at 544.
190. *Id.*
191. *Id.*
192. *Id.* at 545.
193. *Id.*
194. *Id.*
195. *See* Alberta Energy Partners v. Blast Energy Servs., Inc. (*In re* Blast Energy Servs., Inc.), 593 F.3d 418, 422-28 (5th Cir. Jan. 2010).

Circuit's own words, "[t]he procedural background is a bit of a maze."[196] In 2006, Blast Energy Services and Alberta Energy Partners entered into a contract that transferred a 50% interest in technology developed by Alberta to Blast.[197] As part of this contract, Blast and Alberta agreed to work together to develop and manage the technology.[198] In 2007, however, Blast filed for bankruptcy under Chapter 11.[199] During the bankruptcy proceedings, Alberta filed several motions in an attempt to have the contract deemed rejected or compel rejection of the contract.[200] The bankruptcy court denied all of Alberta's motions, and Alberta took appeal to the district court.[201] While the consolidated appeals were pending at the district court, Blast proposed and confirmed a plan that assumed the contract between Blast and Alberta.[202] Alberta immediately appealed the confirmation order and sought a stay pending appeal from the bankruptcy court.[203] The bankruptcy court denied the stay, and that evening, Alberta filed an emergency motion for stay pending appeal and expedited consideration with the district court.[204] Between the confirmation and the hearing on Alberta's stay motion, Blast distributed over $2 million under the plan, thereby substantially consummating it.[205] The district court denied Alberta's stay motion and later issued an order granting Blast's motion to dismiss Alberta's confirmation appeal.[206] Instead of filing an appeal of the order dismissing its appeal, Alberta filed a motion for rehearing, which was denied and then appealed.[207]

While Alberta's motion for rehearing was pending, Alberta and Blast entered into a joint stipulation that provided Alberta would withdraw its appeal of the confirmation order and the confirmation order would not be res judicata or collateral estoppel to Alberta's consolidated appeals still pending in the district court.[208] During a status conference before the district court, Blast stated that despite substantial consummation of the plan, granting relief to Alberta on the consolidated appeals would not affect the plan or third parties.[209] Again, the parties entered into a joint stipulation, this time stating that assumption of the contract was not essential to Blast's reorganization and that relief in favor of Alberta on the consolidated

196. *Id.* at 421.
197. *Id.*
198. *Id.* at 421-22.
199. *Id.* at 421.
200. *Id.* at 422.
201. *Id.* The appeals were consolidated at the district court. *Id.*
202. *Id.*
203. *Id.*
204. *Id.*
205. *Id.*
206. *Id.*
207. *Id.*
208. *Id.*
209. *Id.*

appeals would not require modification of the plan in violation of the Bankruptcy Code.[210] The district court did not approve of the joint statement and denied it, along with Alberta's motion for rehearing and its consolidated appeals under the doctrine of equitable mootness.[211]

After sorting out this procedural nightmare, the Fifth Circuit addressed the district court's assessment of equitable mootness.[212] The Fifth Circuit discussed the nature of equitable mootness, recognizing that it allows an appellate court to decline to review an otherwise viable appeal when a Chapter 11 reorganization has progressed too far for the requested relief to be practicably granted.[213] Equitable mootness is a prudential limitation, not a jurisdictional limitation.[214] The Fifth Circuit, next, set forth the three-pronged analysis used in determining equitable mootness: (1) whether a stay has been granted; (2) whether substantial consummation of the plan has occurred; and (3) whether the requested relief would affect third parties not before the court or the success of the plan.[215] While no set weight has been given to each prong, the first two tend to affect the third, i.e., if a stay has not been granted and the plan has been substantially consummated, then most likely the requested relief will either affect third parties or the success of the plan.[216] Nonetheless, substantial consummation is not fatal to all appeals of a confirmed plan.[217] The Fifth Circuit explained that equitable mootness should be applied like a scalpel instead of an axe, allowing the court to "'fashion whatever relief is practical' instead of declining review simply because full relief is not available."[218]

After looking at the record and the evidence, the Fifth Circuit held the doctrine of equitable mootness did not prevent appellate review in this case.[219] The Fifth Circuit determined that the parties did not claim that Alberta's requested relief would affect third parties or unravel the plan.[220] In fact, Blast admitted that the requested relief would not do so and that the contract assumption issue was not essential to its successful reorganization.[221] The Fifth Circuit held that no evidence before it demonstrated why the doctrine of equitable mootness should apply.[222]

---

210. *Id.*
211. *Id.*
212. *Id.* at 423.
213. *Id.* at 424.
214. *Id.*
215. *Id.*
216. *Id.*
217. *Id.* at 424-25.
218. *Id.* at 425 (citations omitted).
219. *Id.*
220. *Id.*
221. *Id.* at 426.
222. *Id.*

XI. ABSOLUTE PRIORITY RULE: CASH PAYMENT TO SECURED CREDITORS OF FULL AMOUNT OF CLAIM HELD TO BE INDUBITABLE EQUIVALENT OF THEIR CLAIM (*IN RE PACIFIC LUMBER CO.*)

Pacific Lumber Company, along with five other affiliated entities, filed for Chapter 11 bankruptcy.[223] Pacific "owned and operated a sawmill, a power plant, and the town of Scotia, California."[224] Marathon Structured Finance held a secured claim against Pacific's assets.[225] Pacific also owned a wholly-owned subsidiary called Scotia Pacific LLC.[226] Prior to the bankruptcy case, Pacific transferred to Scotia more than 200,000 acres of redwood timberland secured by notes and Scotia's other assets.[227] The Bank of New York was the indentured trustee for the noteholders.[228] At the time of the bankruptcy filing, Scotia owed the noteholders approximately $740 million in principal and interest.[229]

As the bankruptcy proceedings dragged on for a year without progress toward a plan, the bankruptcy court allowed competing plans to be filed and terminated the debtors' exclusivity period.[230] Five competing plans were filed, but three were later withdrawn, leaving only two.[231] The two plans were from Marathon and the Bank of New York.[232] The bankruptcy court approved Marathon's plan, which dissolved the six entities and formed two new entities—Townco and Newco.[233] The plan also created twelve classes of claims, four of which contained claims against Scotia and seven of which were entitled to vote.[234] In particular, Class 6 contained the secured claims of the noteholders and proposed to pay them the value of their collateral and grant a lien on proceeds from potential litigation.[235] Class 8 consisted of unsecured claims of Scotia and proposed to pay them some amount that was undetermined.[236] Class 9 consisted of the noteholders' deficiency claims for over $200 million with an unknown recovery.[237] Class 8 voted for the

---

223. *See* Bank of N.Y. Trust Co. v. Official Unsecured Creditors' Comm. (*In re* Pacific Lumber Co.), 584 F.3d 229, 236 (5th Cir. Sept. 2009). This opinion contains several issues of bankruptcy law including equitable mootness, the absolute priority rule, non-debtor releases, and substantive consolidation. *See id.* The author has chosen to focus on the issue regarding the absolute priority and the relevant facts pertaining to that issue.

224. *Id.*

225. *Id.*

226. *Id.*

227. *Id.*

228. *Id.* at 236-37.

229. *Id.* at 237.

230. *Id.*

231. *Id.*

232. *Id.*

233. *Id.*

234. *Id.* at 238.

235. *Id.*

236. *Id.*

237. *Id.*

plan, while Classes 6 and 9 voted against the plan, requiring the plan to be crammed down pursuant to § 1129(b) of the Bankruptcy Code.[238] To determine whether the court could cram down the plan, the bankruptcy court had to first determine the value of the collateral securing the noteholders' claim.[239] After extensive testimony on valuation, the bankruptcy court determined that the "indubitable equivalent" of the noteholders' secured claim was $510 million.[240] Marathon's plan provided that the noteholders' would receive $513.6 million in cash, any potential recovery of their unsecured deficiency, and a lien on future litigation proceeds.[241] The bankruptcy court approved Marathon's plan, and the Bank of New York, along with individual noteholders, appealed the confirmation arguing that the plan violated the absolute priority rule.[242]

The Fifth Circuit, in determining whether Marathon's plan violated the absolute priority rule, looked to the statutory construction of § 1129(b) and case law interpreting that section.[243] Beginning with the language of § 1129(b)(2)(A), the Fifth Circuit noted three minimum alternatives for secured creditors.[244] A plan can be crammed down over the objection of a secured creditor if the secured party retains its lien on the collateral and receives deferred cash payments equaling the present value of its collateral; the collateral may be sold free of liens, which will attach to the proceeds if the secured party is allowed to credit bid; or the secured party must realize the indubitable equivalent of their secured claims.[245] These three requirements are alternatives and all need not be met; in fact, these alternatives are not exclusive.[246]

The Fifth Circuit held that the noteholders received the "indubitable equivalent" of their secured claims.[247] While indubitable equivalent is neither defined in the Bankruptcy Code nor explained in case law, the Fifth Circuit held that it is "no less demanding a standard than its companions."[248] The Fifth Circuit reasoned that the indubitable equivalent must take into account the "repayment of principal and the time value of money."[249] As examples, the Fifth Circuit noted that abandonment of the collateral to the class or a replacement lien on similar collateral would constitute the indubitable equivalent of the secured claim.[250] In this case,

238. *Id.*
239. *Id.*
240. *Id.*
241. *Id.* at 239.
242. *Id.*
243. *Id.* at 244-49.
244. *Id.* at 245.
245. *Id.* (citations omitted).
246. *Id.*
247. *Id.* at 246-47.
248. *Id.* at 246.
249. *Id.*
250. *Id.*

the noteholders were to receive cash equal to the value of the collateral on the effective date of the plan.[251] Because the noteholders were to receive cash equal to their allowed secured claims, the Fifth Circuit held that the noteholders received the indubitable equivalent of their claim and the plan could be crammed down.[252]

The noteholders attempted to claim that the bankruptcy court erred in valuing the timberlands or its collateral.[253] Further, the noteholders argued that failure to allow it to credit bid prevented the noteholders from getting the indubitable equivalent of their claim.[254] The Fifth Circuit held, however, that based on the valuation testimony before the bankruptcy court, the bankruptcy court did not abuse its discretion in valuing the timberlands.[255]

XII. CONCLUSION

The decisions discussed above have changed the landscape of bankruptcy practice. Trustees must now be more cognizant of large creditors when seeking settlement.[256] Debtors can no longer attempt to game the system by filing bankruptcy and then dismissing their case when bankruptcy is no longer advantageous.[257] Finally, the Fifth Circuit has provided guidance on how to determine the indubitable equivalent of a secured creditor's claim.[258]

251. *Id.* at 246-47.
252. *See id.* at 247.
253. *Id.* at 247-48.
254. *Id.* at 247.
255. *Id.* at 248-49.
256. *See* Cadle Co. v. Mims (*In re* Moore), 608 F.3d 253, 266 (5th Cir. June 2010).
257. *See* Jacobsen v. Moser (*In re* Jacobsen), 609 F.3d 647, 660-61 (5th Cir. June 2010).
258. *See In re Pacific Lumber*, 584 F.2d at 246.