Preserving and Prosecuting Causes of Action Post-Confirmation

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I. The Importance of Preserving Causes of Action In A Chapter 11 Plan

Often a debtor's litigation claims are a valuable asset of the estate. But if a debtor does not include specific language in its plan preserving its claims and causes of action against third parties for later prosecution, then it risks losing such claims and causes of action upon emergence:

- *Preclusion*. A confirmation order, like any final order, has preclusive effect and bars any claims that could have been brought before confirmation. This includes claims that could have been brought *by the debtor* prior to confirmation, such as avoidance claims. Absent preservation, the plan and confirmation order will become *res judicata* as to all such claims. *See, e.g., Fleet Nat'l Bank v. Gray (In re Bankvest Cap. Corp.),* 375 F.3d 51 (1st Cir. 2004); *Elk Horn Coal Co. v. Conveyor Mfg. & Supply, Inc. (In re Pen Holdings, Inc.),* 316 B.R. 495 (Bankr. M.D. Tenn. 2004).

- *Standing*. When a chapter 11 plan is confirmed, the debtor loses its debtor-in-possession status and with it, standing to pursue the estate's claims. *See, e.g., MPF Corp. v. Anderson (In re MPF Holdings US LLC)*, 701 F.3d 449, 453 (5th Cir. 2012). If the debtor takes no action to preserve estate claims in the plan, then the debtor or its post-confirmation representative will lack the ability to assert the claims. *See generally* Roye Zur, Preserving Estate Causes of Action for Post-Confirmation Litigation, 32 CAL. BANKR. J. 427, 427 (2013) (collecting cases).

By preserving estate claims and then transferring them to a post-confirmation entity, a chapter 11 plan creates standing for that entity to prosecute such claims. By expressly leaving open the possibility of a future judgment on the claim, the confirmation order will not be considered a final order on the merits of the claim and, as such, will not have any preclusive effect. *See, e.g., Spicer v. Laguna Madre Oil & Gas II, L.L.C. (In re Texas Wyoming Drilling, Inc.),* 647 F.3d 547, 549, 553 (5th Cir. 2011).

II. Bankruptcy Code Authority For Preserving Causes of Action in a Chapter 11 Plan

The Bankruptcy Code authorizes the preservation of claims in § 1123(b)(3), which states that a plan may:

provide for--

> (A) the settlement or adjustment of any claim or interest belonging to the debtor or to the estate; or
>
> (B) the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest.

11 U.S.C. § 1123(b)(3).

Section 1123(b)(3)'s purpose is to provide notice of potential estate recoveries to *creditors*. It is not meant to provide notice to *potential defendants* that they might be sued. *Elk Horn Coal Co. v. Conveyor Mfg. & Supply, Inc. (In re Pen Holdings, Inc.)*, 316 B.R. 495 (Bankr. M.D. Tenn. 2004).

Two recurring issues consistently arise in the case law:

1. Under § 1123(b)(3)(B), the chapter 11 plan must "retain" the claim, but how? How specifically must the plan identify and describe the claim to adequately preserve it?

2. The claim to be retained must belong "to the debtor or to the estate." 11 U.S.C. § 1123(b)(3). But what if, for example, a liquidation trustee seeks to assert creditor claims? Is this ever permissible?

III. What Language Is Required To Retain Claims? How Specific Must The Language Be?

Most courts generally agree that pure "blanket reservations" purporting to preserve "all claims belonging to the debtor" are insufficiently specific to preserve any particular claim, because the language gives no indication of what claims might exist.

But beyond this extreme example, there is (at first glance) no uniform agreement among courts as to what language is sufficient to preserve a claim. Courts generally fall within one of two camps: some hold that general descriptions of claim types (*e.g.*, "all avoidance claims," "all claims arising under 11 U.S.C. §§ 547, 548, *etc*…") are sufficiently specific to preserve any claims falling within those categories. Other courts, however, hold that more specificity is required, such as identification of specific claims, defendants and/or transactions.

A. Categorical Preservation Language Accepted

Courts that have blessed plan language identifying general categories or types of claims rely on the fact that Bankruptcy Code § 1123(b)(3)(B) does not require that any specific language or "magic words" be used to preserve a claim. Many courts also note that that it is impractical to expect a debtor (particularly in a large chapter 11 case) to have completed its investigation of all claims prior to confirmation. A representative sample of cases follows:

- *Guttman v. Martin (In re Railworks Corp.)*, 325 B.R. 709 (Bankr. D. Md. 2005) ("A reservation is sufficient if it reserves a category or type of claim, and it is not required that individual claims and specific defendants be specified"; holding that language preserving "claims for the avoidance of any transfer … under chapter 5 of the Bankruptcy Code" was sufficient to preserve avoidance claims.).

- *Fleet Nat'l Bank v. Gray (In re Bankvest Cap. Corp.)*, 375 F.3d 51 (1st Cir. 2004) (plan language preserving "Causes of Action," the definition of which included avoidance actions, was sufficient to preserve avoidance claim against lender).

- *Cooper v. Tech Data Corp. (In re Bridgeport Holdings, Inc.)*, 326 B.R. 312 (Bankr. D. Del. 2005) (holding that language preserving "all Causes of Action arising under sections 544 [and] 547 through 551" sufficiently preserved a preference claim, even though the plan did not specifically identify any particular claims).

- *Connolly v. City of Houston (In re Western Integrated Networks, LLC)*, 322 B.R. 156 (Bankr. D. Colo. 2005) (language preserving "any claim or interest belonging to [the debtor], including any claims or interests arising under Section 547 through 551 of the Bankruptcy Code" was sufficient to preserve claims despite not identifying any defendants or any specific causes of action).

- *P.A. Benger & Co. v. Bank One (In re P.A. Benger & Co.)*, 140 F.3d 1111, 1117 (7th Cir. 1998) ("While there might be some logic in requiring 'specific and unequivocal' language to preserve claims belonging to the estate that have never been raised, the statute itself contains no such requirement. The courts that have spoken of the need for 'specific' and 'unequivocal' language have focused on the requirement that plans unequivocally retain claims of a given type, not on any rule that individual claims must be listed specifically.").

- *Alary Corp. v. Sims (In re Associated Vintage Group, Inc.)*, 283 B.R. 549 (9th Cir. B.A.P. 2002) ("A plan, as here, may provide that particular causes of action, or categories of causes of action, are preserved….").

- *Ampace Freightlines, Inc. v. TIC Fin. Sys. (In re Ampace Corp.)*, 279 B.R. 145 (Bankr. D. Del. 2002) (The plan preserved "all avoidance actions," and the disclosure statement incorporated the statement of financial affairs, which listed every transfer made during the ninety day period prior to the petition date. This language was sufficiently specific to preserve a preference claim: "[I]n my opinion, a general reservation in a plan of reorganization indicating the *type* or category of claims to be preserved should be sufficiently specific to provide creditors with notice that their claims may be challenged post-confirmation."). *Id.* at 160-61 (emphasis in original).

B. Categorical Preservation Language Rejected

Other courts hold that "specific and unequivocal" language is required to preserve a claim. Note that these courts do not necessarily endorse the proposition that all claims must be specifically listed, or that all potential defendants must be identified. Indeed, courts falling into this group sometimes endorse categorical descriptions:

- *In re United Operating, LLC*, 540 F.3d 351 (5th Cir. 2008) (The plan reserved (1) any and all claims arising under the Bankruptcy Code and (2) claims arising under certain specifically identified provisions of the Bankruptcy Code. But this language was insufficient to preserve *common law* claims that the debtor sought to assert).
    - Although *United Operating* is one of the seminal cases cited for the proposition that categorical descriptions are insufficient, more recent cases applying *United Operating* have approved categorical descriptions:
    - *Spicer v. Laguna Madre Oil & Gas II, L.L.C. (In re Texas Wyoming Drilling, Inc.)*, 647 F.3d 547, 549, 551 (5th Cir. 2011) (disclosure statement preserving claims against "various pre-petition shareholders of the Debtor [for] fraudulent transfer and recovery of dividends paid to shareholders" sufficiently identified claims with specificity even though disclosure statement did not identify defendants by name).
    - *MPF Corp., Ltd. v. Anderson (In re MPF Holdings US LLC)*, 701 F.3d 449 (5th Cir. 2012) (reversing bankruptcy court's holding that in order for preservation language to be specific, it must (1) individually identify the parties to be sued, (2) state that each party will be sued, rather than "may" be sued, and (3) set forth the legal basis for the suit. The plan at issue preserved "All Causes of Action, including but not limited to, (i) any Avoidance Action that may exist against any party identified on Exhibits 3(b) and 3(c) of the Debtors' statement of financial affairs…." This language was specific enough because it stated the basis for recovery and identified potential defendants through the statement of financial affairs.).

- *Moglia v. Keith (In re Manchester, Inc.)*, 2009 WL 2243592 (Bankr. N.D. Tex. 2009) (plan that preserved all "Actions," including "Avoidance Actions" [defined as all claims under, among other things, Bankruptcy Code §§ 547 and 548] was sufficiently specific to preserve avoidance claims (even though it did not identify specific potential defendants), but was insufficient to preserve any non-avoidance claims because the plan did not expressly identify any of these other claims).

- *Browning v. Levy*, 283 F.3d 791 (6th Cir. 2002) (holding that language preserving "any claims, rights and causes of action that the Debtor or its bankruptcy estate may hold against any person or entity, including, without limitation, claims and causes of action arising under section 542, 543, 544, 547, 548, 550 or 553 of the Bankruptcy Code" did not preserve claims for breach of fiduciary duty and legal malpractice. The reservation did not mention any such claims, did not identify the target of the claims, and did not discuss the factual basis for the claims.).

  - *But see Elk Horn Coal Co. v. Conveyor Mfg. & Supply, Inc. (In re Pen Holdings, Inc.)*, 316 B.R. 495 (Bankr. M.D. Tenn. 2004) (language preserving "Avoidance Actions" [defined to include claims under Bankruptcy Code § 547] was sufficiently specific to preserve a preference claim. *Browning* was not controlling because *Browning* dealt with whether a categorical preservation of avoidance claims could also preserve non-avoidance claims like breach of fiduciary duty. By contrast, here the question was whether a plan's preservation of "avoidance actions" was sufficient to preserve a preference claim: "Browning does not establish a general rule that naming each defendant or stating the factual basis for each cause of action are the only ways to preserve a cause of action.... Read in the context of its history, § 1123(b)(3) protects the estate from loss of potential assets. It is not designed to protect defendants from unexpected lawsuits. The words sufficient to satisfy § 1123(b)(3) must be measured in the context of each case and the particular claims at issue: Did the reservation allow creditors to identify and evaluate the assets potentially available for distribution?").

- *Kelley v. South Bay Bank (In re Kelley)*, 199 B.R. 698 (9th Cir. B.A.P. 1996) (the plan provided that: "[w]ithin thirty (30) days of the date of Plan Confirmation, the Debtors shall initiate adversary proceedings to contest the amount, allowability, priority and/or secured status of any claims which the Debtors believe are not proper. The Debtors may at the same time bring any counter-claims that they believe proper against any creditors asserting claims." The disclosure statement further provided that "[i]t is possible that the [Debtors] may have various counter claims against South Bay Bank." The court held that this language was insufficient to preserve a counterclaim against South Bay Bank, because the language did not specify the grounds for any potential counterclaim).

  - *But see Alary Corp. v. Sims (In re Associated Vintage Group, Inc.)*, 283 B.R. 549 (9th Cir. B.A.P. 2002) (noting that *Kelley* does not stand for proposition that a general reservation of rights is never sufficient to preserve claims).

- *Retail Mktg. Co. v. King (In re Mako, Inc.)*, 985 F.2d 1052 (10th Cir. 1993) (Under the plan, a third party purchased the debtor's assets, including certain causes of action. The plan transferred all pending adversary proceedings to the purchaser, and further provided that the purchaser "may appear as the real party in interest in any pending or later instituted contested matter or adversary proceeding filed herein." The Court held that this language was ambiguous as to whether it preserved any avoidance actions commenced after confirmation, and therefore the language did not possess the requisite specificity to preserve avoidance actions in favor of the purchaser.).

C. Attempting To Reconcile The Cases

Whether plan language sufficiently preserves a claim is a fact-specific inquiry, but there are certain recurring facts that help explain the differing results in the cases above.

- *Less specificity required for avoidance claims?* Numerous courts have held that a categorical reference to "avoidance claims" or "claims arising under Bankruptcy Code §§ 547, 548, etc…" is sufficient to preserve such claims. By contrast, many of the stricter cases cited above dealt with common law claims that were not identified in preservation clauses that referred only to avoidance claims. *E.g.*, *In re United Operating, LLC*, 540 F.3d 351 (5th Cir. 2008); *Browning v. Levy*, 283 F.3d 791 (6th Cir. 2002). Hence, an argument can be made that even under these stricter cases, categorical reservations are fine, as long as the claim at issue falls within the category. The question still remains, however, whether purely categorical descriptions such as "breach of fiduciary duty claims, "malpractice claims" or other similar claim types will suffice.

- *Less specificity required in large chapter 11 cases?* Some courts have allowed categorical preservation language on the basis that it would be highly impractical to expect a debtor in a large chapter 11 case to identify every claim and every defendant in advance of confirmation. *See, e.g., Elk Horn Coal Co. v. Conveyor Mfg. & Supply, Inc. (In re Pen Holdings, Inc.)*, 316 B.R. 495, 504 (Bankr. M.D. Tenn. 2004) ("It is not practicable, especially in larger cases, for the debtor to identify by name in the plan or disclosure statement every entity that may have received a preferential payment"); *Ampace Freightlines, Inc. v. TIC Fin. Sys. (In re Ampace Corp.)*, 279 B.R. 145, 159 (Bankr. D. Del. 2002) ("Indeed, in large chapter 11 cases, the investigation and litigation of all possible avoidance actions to final judgment can take years. To force the debtor to remain in bankruptcy until a final determination of all possible preference actions is made would act as a detriment to both the debtor and it creditors by slowing down the reorganization process").

- *Was the cause of action known before the petition date or confirmation date?* Some courts have given this consideration weight in determining whether the plan should have specifically identified the claim. *See, e.g., Cooper v. Tech Data Corp. (In re Bridgeport Holdings, Inc.)*, 326 B.R. 312, 319, 320-21 (Bankr. D. Del. 2005) (distinguishing two cases involving claims known to the debtor prior to confirmation; by contrast, the

Bridgeport debtor did not know of the claims in advance, a fact supporting the court's holding that the claims were preserved).

- The two cases that *Bridgeport* distinguished were *D&K Props. Crystal Lake v. Mutual Life Ins. Co.*, 112 F.3d 257 (7th Cir. 1997) and *Kelley v. South Bay Bank (In re Kelley)*, 199 B.R. 698 (9th Cir. B.A.P. 1996).

- In *D&K Props.*, the debtor already had sued the defendant on a related claim prior to the bankruptcy case, and further litigation ensued in the bankruptcy case. 112 F.3d at 259. The fact that the claim was known to the debtor, along with inadequate blanket preservation language, led the court to conclude that any post-petition claim was *res judicata*.

- In *Kelley*, the debtor knew of the circumstances giving rise to the claim months before confirmation. 199 B.R. at 703. Thus, the debtor *could* have asserted the claims prior to confirmation, and by not adequately preserving the claims in the plan, the claims were barred as *res judicata*. *Id.* at 704.

D. May Documents Other Than The Plan Preserve Claims?

Disclosure Statement. Courts generally will consider preservation language in a disclosure statement, since the disclosure statement's purpose is to provide notice of the plan and its provisions. *Spicer v. Laguna Madre Oil & Gas II, L.L.C. (In re Texas Wyoming Drilling, Inc.)*, 647 F.3d 547, 549, 551 (5th Cir. 2011) (disclosure statement is the "primary notice mechanism informing a creditor's vote for or against a plan" and therefore "[c]onsidering the disclosure statement to determine whether a post-confirmation debtor has standing is consistent with the purpose of … placing creditors on notice of the claims the post-confirmation debtor intends to pursue."); *Goldin Assocs., L.L.C. v. Donaldson, Lufkin & Jenrette Secs. Corp.*, 2004 WL 1119652, at *3 (S.D.N.Y. May 20, 2004) ("Although the Bankruptcy Code speaks in terms of reservations in the plan, a debtor can preserve its right to litigate claims in either the plan or the disclosure statement").

Schedules and Statements of Financial Affairs. Courts also have considered references to the bankruptcy schedules and statement of affairs, particularly to lists of transfers made within the 90 days before the petition date. *MPF Corp., Ltd. v. Anderson (In re MPF Holdings US LLC)*, 701 F.3d 449 (5th Cir. 2012).

E. Best Practices

Given the apparent disagreement among courts and the lack of a uniform rule, the best practice is to be as specific as possible when drafting preservation language for a plan. Obviously how specific the language can be will depend on the circumstances.

- Although courts will consider language contained in a disclosure statement, the plan itself always should contain preservation language.

- To the extent a plan seeks to preserve avoidance actions or other claims arising under the Bankruptcy Code, it should identify the relevant Bankruptcy Code sections by name, *e.g.*, "all claims arising under Bankruptcy Code sections 544, 547, 548, etc…" If practicable, the plan and disclosure statement also should refer to the schedules and statements of financial affairs, including any lists of transfers made during the avoidance period.

- To the extent the plan seeks to preserve claims that do not arise under the Bankruptcy Code, best practice is to include as much detail as possible. At the very least, the type of claim should be described, *e.g.*, "breach of fiduciary duty claims." It also would be prudent to identify the defendants, if even by class, *e.g.*, "breach of fiduciary duty claims against former officers and directors of the debtor." The more detail that is provided, the greater the protection against a motion to dismiss for lack of compliance with Bankruptcy Code § 1123(b)(3).

- In a large chapter 11 case with many potential claims, the disclosure statement should describe the efforts undertaken to date to analyze potential litigation claims, and efforts expected to be undertaken in the future. This helps demonstrate the impracticability of identifying all potential claims with specificity.

IV. Standing To Assert Creditor Claims; Effect Of Assignment

Bankruptcy Code § 1123(b)(3) allows a debtor to preserve only estate claims. Does this mean a debtor can never assert personal creditor claims, even if the creditor assigns the claim to the debtor?

In the absence of an assignment, a debtor cannot assert claims belonging personally to creditors. Put simply, the claims do not belong to the estate. This was the holding in the seminal case *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972). *Caplin* held that a bankruptcy trustee under Chapter X of the Bankruptcy Act lacked standing to assert claims belonging to certain bondholder creditors. The Court found nothing in the Bankruptcy Act authorizing a trustee to sue third parties on behalf of creditors. *Id.* at 428-29. Further, allowing a bankruptcy trustee to assert creditor claims would give rise to complications: would the creditors be able to simultaneously assert the claims (which, after all, belong to them)? What of the potential for inconsistent results? One can also think of due process and constitutional concerns that may arise.

- *Caplin* is still good law under the Bankruptcy Code, and courts have extended its holding to chapter 7 trustees. *See, e.g., Mixon v. Anderson (In re Ozark)*, 816 F.2d 1222, 1228 (8th Cir. 1987) ("we believe Congress' message is clear -- no trustee, whether a reorganization trustee as in Caplin or a liquidation trustee as in the present case, has power under section 544 of the Code to assert causes of action, such as the alter ego claim, on behalf of the bankruptcy estate's creditors.") (emphasis in original).

- Courts also have extended *Caplin's* holding to trustees of post-confirmation trusts.

    - *Torch Liquidating Trust v. Stockstill*, 2008 WL 696233 at *6 n.4 (E.D. La. Mar. 13, 2008) ("prior case law is explicit that Litigation Trusts such as plaintiff do not have standing to pursue the direct claims of creditors").

    - *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 191 (Del. Ch. 2006) ("Federal bankruptcy law is clear that litigation trusts do not have standing to pursue the direct claim of creditors…. [Under *Caplin*,] bankruptcy trustees and litigation trusts formed as part of reorganization plans do not have standing to bring claims belonging to creditors under the federal bankruptcy statute.").

    - *Mukamal v. Bakes*, 383 B.R. 798, 811-12 (S.D. Fla. 2007) (citing *E.F. Hutton & Co. v. Hadley*, 901 F.2d 979 (11th Cir. 1990) (plan trustee lacked standing to assert creditor claims, at least where he did not obtain full assignments).

But when a creditor voluntarily assigns its claim to a bankruptcy or post-confirmation trustee, the question becomes more difficult. There is a split of authority on the issue. On the one hand, a few cases have held that a trustee still lacks standing to assert creditor claims even where a creditor assigns its claim to the estate:

- The lead case is *Williams v. California 1st Bank*, 859 F.2d 64, 665 (9th Cir. 1988). There, the trustee had sent a letter to creditors asking them to assign their claims, and over one hundred did. But importantly, the assignments provided that the trustee would prosecute the claims only on behalf of the assigning creditors. In other words, the trustee would distribute none of the proceeds to non-assigning creditors. The Court found that this provided no benefit to the estate, as the assigning creditors remained the real parties in interest, and the trustee was not collecting money owed to the estate. *Id.* at 666, 667.

- Another court has explicitly extended this rule to litigation trustees. *See Kipperman v. Onex Corp.*, 411 B.R. 80, 831 n.21 (N.D. Ga. 2009) ("Litigation trustees do not have standing to directly pursue claims on behalf of creditors and creditors may not assign their claims to a litigation trust").

But a number of recent cases reject this position and distinguish *Caplin* and its progeny where creditors formally assign their claims. These courts reason that under Bankruptcy Code § 541(a)(7), property of the estate includes any interest that the estate acquires post-petition. So when a creditor assigns a claim, the claim becomes part of the estate, and the bankruptcy or post-confirmation trustee has standing to assert the claim. Some courts have blessed this rule even when the trustee agrees to assert the claims solely on behalf of the assigning creditors, and not on behalf of the estate generally.

- *Bankruptcy Servs., Inc. v. Ernst & Young, LLP (In re CBI Holdings Co., Inc.)*, 529 F.3d 432 (2d Cir. 2008) ("Allowing a debtor's creditors to assign their claims for the benefit of the debtor's estate permits debtors, creditors, and bankruptcy courts the flexibility in reorganizing or liquidating a debtor's assets necessary to achieve efficient administration of the reorganization or liquidation. Indeed, the voluntary and court-approved assignment at issue in this case perfectly illustrates how both a debtor and its creditors can benefit from the flexibility that § 541(a)(7) of the Bankruptcy Code facilitates.").

- *Grede v. Bank of New York Mellon*, 598 F.3d 899, 901 (7th Cir. 2010) (rejecting Ninth Circuit's *Williams* decision and holding that litigation trust may pursue claims assigned to it, even if solely for the benefit of the assigning creditors: "We conclude that *Caplin* does not apply to the activities of a liquidating trust created by a plan of reorganization (or, for that matter, an ex-debtor operating under a confirmed plan)).

- *Logan v, JKV Real Estate Servs. (In re Bogdan)*, 414 F.3d 507, 512 (4th Cir. 2005) (noting that the concerns raised in *Caplin,* such as the potential for multiple inconsistent litigations, are eliminated when claims are assigned; holding that chapter 7 trustee had standing to assert assigned claims).

- *Semi–Tech Litigation, LLC v. Bankers Trust Co*., 272 F.Supp.2d 319, 323–24 (S.D.N.Y. 2003), affirmed & adopted, 450 F.3d 121, 123 (2d Cir. 2006) (rejecting *Williams* and holding that assignee under chapter 11 plan had standing to assert claim).

- *Steinberg v. Kendig (In re Ben Franklin Retail Stores, Inc.)*, 225 B.R. 646, 650 (N.D. Ill. 1998) ("The assignments effectively turned the unsecured creditors' causes of action into property of the estates and the [Chapter 7] Trustee has a duty to marshal those assets for the benefit of the estates.").

- *Taberna Capital Mgmt., LLC v. Jaggi*, 2010 WL 1424002, at *3 (S.D.N.Y. Apr. 9, 2010) ("*Caplin* was decided under circumstances in which a formal assignment of claims by the creditors had not occurred…. The Second Circuit has held that a bankruptcy trustee who obtains valid assignments of claims is not prevented from suing on those claims simply because the assignee is a creature of bankruptcy").

- *Cf. Lasala v. Bordier et Cie*, 519 F.3d 121, 127 n.1 (3d Cir. 2008) (noting in *dicta*, but with approval, that confirmed plan had assigned individual causes of action to litigation trust).

The bottom line is that disagreement exists about whether a post-confirmation trust may assert creditor claims, even where the creditors affirmatively assign the claim, although in some circuits (notably the second and seventh), the law now is clear that a trustee may assert such claims.

There also is some authority in the Ninth Circuit (*Williams*) that may require any assignment to benefit the entire estate and not just the assigning creditors. This would call into question whether a plan can ever provide for the creation of a "creditor trust," in other words, a trust that does not act on behalf of the estate but that only acts on behalf of assigning creditors. Such trusts, however, have been approved in complex cases in other circuits.

- *See, e.g.*, *In re Tribune Co.*, 464 B.R. 126, 193 (Bankr. D. Del. 2011) ("I agree with *Grede's* and *Semi–Tech's* analysis and conclude that the Plan's establishment of the Creditors' Trust and procedure for assignment of creditors' claims is not inconsistent with *Caplin*. The Plan's claim assignment procedure is voluntary because it allows creditors to 'opt out.' The possibility of inconsistent results is no greater than if the creditors pursued their separate claims individually. Moreover, the Creditors' Trustee is not acting as a representative of the Debtors or their estates, so the concerns for statutory trustees expressed in *Caplin* are not raised by this Plan provision.") (citations omitted)).

- *Kirschner v Bennett*, 648 F.Supp.2d 525, 531 (S.D.N.Y. 2009) (considering claims brought by trustee of the Refco Inc. "Private Actions Trust." Refco's plan "provided for the establishment of a Private Actions Trust which was formed to prosecute 'non-estate' claims—i.e., claims owned by Refco creditors or shareholders that were 'independent' of those held by the Refco Debt.").

- *Weisfelner v. Fund 1 (In re Lyondell Chem. Co.)*, --- B.R. ----, 2014 WL 118036, at *4 (Bankr. S.D.N.Y. Jan. 14, 2014) (noting that plan set up creditor trust to which creditors would contribute state law avoidance claims, and approving assertion of those claims free of Bankruptcy Code § 546(e)'s bar).

V. Post-Confirmation Trusts

Plans often set up one or more post-confirmation trusts to collect, administer and distribute assets of the estate.

- In a liquidation case, there is no operating debtor to perform this task after confirmation. So a post-confirmation trust allows for confirmation despite the fact that certain assets have not yet been liquidated.

- In a reorganization case, there still is benefit to separating post-confirmation administration matters from the reorganized entity. Setting up a post-confirmation trust removes a source of distraction from post-confirmation management, and allows the trustee to operate on its own timeline unaffected by the needs of the operating company. Post-confirmation trusts also allow for a quicker emergence from bankruptcy, which benefits the debtor by disassociating it from the stigma of bankruptcy and eliminating the need for court approval of major decisions.

- In both types of cases, by allowing for confirmation before full administration of the estate, post-confirmation trusts reduce the expense associated with bankruptcy.

Most post-confirmation trusts have the following elements:

- They usually are run by a single individual (the trustee) who often is a turnaround professional or a former member of the debtor's management.

- The trust usually is governed by an oversight committee that often consists of creditors who sat on the creditors' committee. The oversight committee usually is represented by the same attorneys who were counsel to the creditors' committee.

- The plan often will include the separate agreements and documents setting up the trust (or other post-confirmation vehicle) and retaining the trustee. The agreements will set out trustee's duties, compensation, powers (including authority to retain professionals), reporting obligations, and funding.

The form of the post-confirmation vehicle may be driven by tax concerns. Post-confirmation trusts usually are taxed as grantor trusts. *See* Thau, Friedland and Geekie, Jr., Postconfirmation Liquidation Vehicles (Including Liquidating Trusts and Postconfirmation Estates): An Overview, 16 J. BANKR. L. & PRAC. 2 Art. 4 (April 2007).

In more complex cases, it may make sense to set up multiple trusts. Sometimes different trusts are set up for different asset types, *e.g.*, a litigation trust for claims and causes of action and a liquidating trust for certain other types of assets. Trusts can also be set up for separate beneficiaries: a liquidating trust that acts on behalf of the estate, and a "creditor trust" that obtains assignments of creditor claims and liquidates those claims on behalf of the assigning creditors. Examples of this latter structure can be found in the *Refco*, *Tribune* and *Lyondell* cases. As discussed below, the potential for creditor trusts to avoid the increasingly expanded §546(e) defense may lead to more trusts of this type in the future.

VI. Creditor Trusts As A Means Of Circumventing Bankruptcy Code § 546(e)

Bankruptcy Code § 546(e) has become a significant defense to the avoidance of any transaction involving the purchase or sale of stock. Section 546(e) protects these transactions from being challenged under certain specific provisions of the Bankruptcy Code, including §§ 544, 547 and 548(a)(1)(B) (but not claims for actual fraudulent transfer under § 548(a)(1)(A)).

Section 546(e) applies to any transfer that is a "settlement payment … made by or to … a … financial institution…" The term "settlement" refers to the settlement system, which is the "system of intermediaries and guarantees usually employed in securities transactions." *Brandt v. B.A. Capital Co. LP (In re Plassein Int'l Corp.)*, 590 F.3d 252, 255 & n.1 (3d Cir. 2009). Section 546(e) was enacted to promote market stability by preventing avoidance of transfers that could then have a domino effect through settlement and clearance chain. While at first glance § 546(e) would seem to implicate only the sale of public shares (since many private sales do not travel through the settlement system), *id.*, most courts have broadly interpreted the term "settlement payment" to mean *any* transfer of cash or securities made to complete a securities transaction, including a private sale of shares. *See*, *e.g.*, *Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, 651 F.3d 329 (2d Cir. 2011); *Brandt v. B.A. Capital Co. LP (In re Plassein Int'l Corp.)*, 590 F.3d 252 (3d Cir. 2009); *QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.)*, 571 F.3d 545 (6th Cir. 2009); *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981 (8th Cir. 2009); *Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.)*, 952 F.2d 1230 (10th Cir. 1991).

These courts also tend to broadly define the phrase "made by or to a financial institution" to mean any transfer that runs through or implicates a financial institution, even if the financial institution acts only as a conduit. For example, if A buys shares from B and pays by wire transfer, the payments are made "by or to" a financial institution, since wire transfers by necessity must pass through a bank. The Eleventh Circuit adopts a stricter approach, holding that a financial institution acting as a pure intermediary does not fall within § 546(e)'s scope. *Munford v. Valuation Research Corp.*, 98 F.3d 604, 610 (11th Cir. 1996).

Thus, in most circuits, § 546(e) is a potent defense that will broadly bar any avoidance claims brought by a debtor against transfers involving the purchase or sale of stock. The defense applies to post-confirmation representatives of the estate as well. *See In re Tribune Co. Fraudulent Conveyance Litig.*, 499 B.R. 310, 319 n.10 (S.D.N.Y. 2013) (citing examples).

But importantly, § 546(e) does not bar claims belonging to individual creditors. By its express terms, § 546(e) applies only to claims brought by "trustees," in other words, estate claims. See 11 U.S.C. § 546(e) ("the *trustee* may not avoid a transfer that is [a settlement payment made to a financial institution]) (emphasis added). Rather than § 546(e), *the automatic* *stay* prevents individual creditors from asserting claims belonging to them. More precisely, the automatic stay divests individual creditors of standing to assert any claim for a "general harm"—a harm experienced by the creditor by virtue of a harm to the company in the first instance. Instead, the debtor has exclusive standing to assert such claims, and creditors are bound by the court's resolution of those claims. *See*, *e.g.*, *St. Paul Fire & Marine Ins. Co. v. PepsiCo, Inc.*, 884 F.2d 688, 700-02 (2d Cir. 1989) ("If a claim is a general one, with no particularized injury arising from it, and if the claim could be brought by any creditor of the debtor, the trustee is the proper person to assert the claim, and the creditors are bound by the outcome of the trustee's action."). A creditor's state law fraudulent transfer claim is a classic claim for general harm, so the bankruptcy trustee retains exclusive standing to assert state law fraudulent transfer claims under Bankruptcy Code § 544, and individual creditors are divested of standing.

But if a debtor or trustee does not bring a fraudulent transfer claim within the 2 year limitations period under § 546(a)(1)(A), or if the debtor otherwise abandons the claims, "a creditor regains standing to pursue a state law fraudulent conveyance action, in its own name and for its own benefit." *Tribune*, 499 B.R. at 321.

Therefore, a debtor can potentially circumvent § 546(e) by abandoning its fraudulent transfer claims, thereby resurrecting individual creditor claims. The debtor can then set up a trust to collect assignments of those individual creditor claims to be asserted on those creditors' behalves. Since § 546(e) does not apply to the resuscitated creditor claims, the trustee of the trust arguably may assert them free of § 546(e)'s bar, even though a trustee asserting the exact same claims under § 544 would run into § 546(e)'s bar.

The reasoning underlying this theory recently was tested in *Tribune* and *Lyondell*. *See In re Tribune Co. Fraudulent Conveyance Litig.*, 499 B.R. 310, 319 n.10 (S.D.N.Y. 2013);

Weisfelner v. Fund 1 (In re Lyondell Chem. Co.), --- B.R. ----, 2014 WL 118036 (Bankr. S.D.N.Y. Jan. 14, 2014).

- In *Tribune*, the estate asserted an actual fraudulent transfer claim under § 548(a)(1)(A), and various creditors then brought independent actions for constructive fraud in state court. The cases were consolidated in New York federal court, which considered a motion to dismiss the creditor claims on the grounds that they were barred by § 546(e). The court held that by its express terms, § 546(e) did not apply to the creditor claims.
    - Nor did § 546(e) preempt the creditor claims. Several courts have held that § 546(e) impliedly preempts state law claims that are functionally equivalent to the claims that § 546(e) expressly bars. The underlying theory is that these functionally equivalent claims would frustrate § 546(e)'s purpose by allowing for the avoidance of a transfer that Congress has deemed unavoidable. *Tribune* distinguished these cases on the grounds that each of them involved a successor trustee to whom § 546(e) applied, and not an individual creditor to whom § 546(e) did not apply. Hence the creditor claims were not barred or preempted by § 546(e).
    - Importantly, though, the court went on to rule that the individual creditors *lacked standing* to assert their individual claims because the litigation trustee already was seeking to avoid the same transfers. It did not matter that the individual creditors were asserting a constructive fraud theory as opposed to the trustee's actual fraud theory. What mattered was that the trustee was seeking to avoid the very same transfers under *any* avoidance theory, thus depriving the individual creditors of standing to do the same.
- So while *Tribune* held that the creditors could not assert their claims, its holding rested on the fact that the trustee already was actively seeking to avoid the same claims. *Tribune* therefore raises the possibility that creditors may assert claims free of § 546(e) if the trustee chooses not to assert the claims.
- This situation was recently considered in *Lyondell*, 2014 WL 118036 (Bankr. S.D.N.Y. Jan. 14, 2014).
    - Under Lyondell's chapter 11 plan, a creditor trust was created to take ownership of state law fraudulent transfer claims contributed by the debtor's creditors. The creditors' committee currently was litigating the estate's avoidance claims, but it affirmatively abandoned those claims under the plan. The creditor trust then sued various defendants under state fraudulent transfer law.
    - For the same reasoning as in *Tribune*, the Court held that the creditor claims were not barred or preempted by § 546(e).

Now that a court has blessed the use of creditor trusts to circumvent § 546(e), creditor trusts may become far more common in any case where § 546(e) potentially could apply to bar claims against a significant transaction. A recent example can be found in *Physiotherapy Holdings, Inc.*, Case No. 13-12965-KG (Bankr. D. Del.), where the plan was confirmed in December 2013. *See* D.I. 18 (plan), 19 (disclosure statement) & 197 (confirmation order). The plan provided for the creation of a litigation trust to which certain creditors could elect to contribute their claims. Consenting creditors would contribute "all" of their claims against certain defendants, including specifically identified classes of claims: all claims based on a certain prepetition transaction, all claims based on the issuance of certain securities, all claims based on the debtor's restatement of its financials, and all claims based on financial misrepresentations. D.I. 19 at 19. Eligible creditors could opt-in to the trust by checking the appropriate box on the plan ballot, and by doing so they would be deemed to automatically assign their claims as of the plan's effective date. *See* D.I. 19 at 53-54. Through this mechanism, the litigation trust can attempt to circumvent any future § 546(e) challenges based on the reasoning set forth in *Lyondell* and *Tribune*.