

Smack-Down of a Straitjacket

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Postconfirmation liquidation and litigation trusts have become an important mechanism in a chapter 11 bankruptcy estate's arsenal, allowing for the resolution of claims and interests without needlessly delaying confirmation in the interim. The specter of postconfirmation litigation may seem unremarkable. Section 1123(b)(3)(B) of the Bankruptcy Code states that a plan may provide for retention or enforcement by the reorganized debtor, the trustee, or a representative of the estate of any claim or interest belonging to the estate. However, the provision does not specify the manner in which the retention of any such claims or interests should be drafted and disclosed to other parties—leaving to the courts the question of the level of specificity and detail required. A recent decision handed down by a Texas bankruptcy court, *In re MPF Holdings US LLC*, 443 B.R. 736 (Bankr. S.D. Tex. 2011), suggested that in that district at least, the level of specificity and detail required is high. However, in *In re Matter of Texas Wyoming Drilling, Inc.*, 647 F.3d 547 (5th Cir. 2011), the Fifth Circuit issued an opinion clarifying that debtors in that circuit, which includes the Southern District of Texas, are not straitjacketed in this regard after all.

Background: The Three Approaches

Decisions on this issue have been varied, with some courts requiring only broad, categorical language; others adopting a more nuanced, middle-of-the-road approach; and still others mandating a precise reservation provision. The first group of courts, exemplified by the Seventh Circuit's ruling in *P.A. Bergner & Co. v. Bank One (In re P.A. Bergner & Co.)*, 140 F.3d 1111 (7th Cir. 1998), and, more recently, the court's decision in *In re Kimball Hill, Inc.*, 449 B.R. 767 (Bankr. N.D. Ill. 2011), requires only broad, categorical language. The second group, attempting

to find a middle ground, focuses on the particular plan language and the history of the case itself. See, e.g., *Elk Horn Coal Co., LLC v. Conveyor Mfg. & Supply, Inc. (In re Pen Holdings, Inc.)*, 316 B.R. 495 (Bankr. M.D. Tenn. 1994). In *Dynasty Oil & Gas, LLC v. Citizens Bank (In re United Operating, LLC)*, 540 F.3d 351 (5th Cir. 2008), the Fifth Circuit placed itself in the third camp, requiring that the plan “expressly retain the right to pursue such causes of action” and that the language doing so be “specific and unequivocal.”

Relaxation of the Fifth Circuit Standard?

Since the *United Operating* ruling was handed down, bankruptcy courts in the Northern District of Texas have criticized the Fifth Circuit’s bright-line test and concluded that seemingly broad reservation provisions were permissible under the “specific and unequivocal” standard. For example, in *Moglia v. Keith (In re Manchester, Inc.)*, 2009 Bankr. Lexis 2003 (Bankr. N.D. Tex. 2009), the court was confronted with a confirmed plan stating that “all Causes of Action shall be transferred to the Litigation Trustee” and that the trustee shall “have the exclusive right to prosecute and enforce any rights to payment of claims or other rights that the Debtors or the Estates may hold against any Person (including Avoidance Actions).” The court determined that *United Operating* did not mandate the identification of specific individuals or entities which would be sued and that the categorical reservation of avoidance claims was sufficient. Accordingly, the court upheld the litigation trustee’s standing to pursue certain preference actions after confirmation.

Likewise, in *Spicer v. Laguna Madre Oil & Gas, LLC (In re Tex. Wyo. Drilling, Inc.)*, 422 B.R. 612 (Bankr. N.D. Tex. 2010), the bankruptcy court upheld standing to sue under similar plan provisions on the ground that *United Operating* does not require the “specific and unequivocal”

language to include identification of specific claims and defendants. The clear import of these cases, therefore, was that debtors providing a generic reservation of the right to pursue preference or other avoidance claims could satisfy the bright-line test set forth in *United Operating*.

The “Straitjacket” of *MPF Holdings*

In *MPF Holdings*, by contrast, a bankruptcy court in the Southern District of Texas adopted a different approach. Applying the standard set forth in *United Operating*, the court concluded that the phrase “specific and unequivocal” requires the plan’s reservation provision expressly to state: (1) the name of the putative defendant; (2) the basis on which the putative defendant will be sued; and (3) that the putative defendant will definitely be sued after confirmation. According to the court, “the language must be so Shermannesque that anyone who reads the proposed plan knows that if the plan is confirmed, the putative defendant will unquestionably be sued post-confirmation under a particular legal theory or statute.”

Specific

In considering whether the plan was sufficiently specific, the court reviewed the retention language of the plan itself. The court began its analysis by noting that the plan expressly identified putative defendants by reference to certain exhibits, which contained the names, addresses, and amounts paid to those putative defendants within 90 days of the petition date. Accordingly, the court judged the plan to be sufficiently specific.

Unequivocal

However, the plan failed in the court’s estimation to satisfy the “unequivocal” prong of the test. The plan stated that the trustee would have the right to prosecute “all causes of action, including

but not limited to, (i) any Avoidance Action that may exist.” The inclusion of the word “may,” the court reasoned, introduced ambiguity as to what causes of action were in fact reserved. The court also found ambiguity insofar as the plan provisions relied upon to establish “specificity” suggested that the basis of litigation was definitely preferential payments (based on the identified payments), but the plan’s language suggested that those preference actions only *might* exist—leaving creditors unable to establish with certainty whether and on what grounds they would be sued.

The court also identified the plan language “excluding any Cause of Action released in connection with or under the Plan or by prior order of the Court” as a basis for concluding that the reservation provision was unclear and prevented creditors from discerning precisely who could and would be sued and the impact on future claims and liabilities. Finally, the court examined the disclosure statement filed in support of the plan. There, the court found further support for its conclusion that the causes of action were not “unequivocally preserved” because the disclosure statement provided that “neither the Debtors nor other parties have identified or fully investigated any potential Avoidance Actions.” As a whole, therefore, the court determined that the reservation provisions could not be said to be “unequivocal,” as the Fifth Circuit standard requires.

The Fifth Circuit Weighs In (Again)

Recently, however, the Fifth Circuit laid much of this debate to rest, affirming the ruling below in *Texas Wyoming* and distancing itself from the *MPF Holdings* “hard line” approach. At the outset of its opinion, the Fifth Circuit noted that the intent behind the specific and unequivocal requirement is to ensure that creditors are on notice, with all information necessary to cast an

intelligent vote. Notice is not the end in itself, however—it is a means to the end of securing a prompt, effective administration of a debtor’s estate. With that in mind, the court explored the implications of the “specific and unequivocal” standard that it previously articulated in *United Operating*.

Specific and Unequivocal

The Fifth Circuit noted that, consistent with *United Operating*, a debtor’s chapter 11 plan and disclosure statement must preserve claims to be litigated postconfirmation. To meet this burden, the court explained, the plan and disclosure statement must identify the types of claims—not simply reserve “any and all.” Language identifying the types of claims (*e.g.*, avoidance actions), the possible amount of recovery, and the basis for the claims as well as the fact that the reorganized debtor or its representative intends to pursue these actions is sufficient. Individual defendants, however, need not be named. Because the putative defendants in *Texas Wyoming* were identified by class (“certain prepetition shareholders”), the Fifth Circuit did not reach the issue of whether a plan that provides no identification would pass scrutiny.

Policy Concerns

According to the *Manchester* and *Texas Wyoming* bankruptcy courts, the larger policy behind many of the Bankruptcy Code’s provisions—maximization of creditor recoveries—could hardly be served by imposing onerous claim-reservation requirements on debtors, particularly where the consequence may well be to bring recovery on these claims down to zero. Those courts, therefore, sought to dilute the *United Operating* standard to ensure that creditors would not suffer adverse consequences from strict application of section 1123(b)(3)(B), the terms of which are arguably quite general.

By contrast, the *MPH Holdings* court determined that the relevant policy judgment had already been made—by the Fifth Circuit in *United Operating*. Rather than emphasizing the preservation of claims for the benefit of the estate, the court in *MPH Holdings* reasoned that the Fifth Circuit in *United Operating* elected to focus on the need for complete, full disclosure to give voting creditors sufficient information to know whether they would—or would not—be sued. Suggesting that the lack of such disclosure comes at the expense of those creditors, the bankruptcy court concluded that the Fifth Circuit determined that it is appropriate to require debtors, rather than postconfirmation litigation trustees, to devote the time and resources necessary to investigate potential claims and identify the ones that will be pursued postbankruptcy.

The Fifth Circuit has clarified in *Texas Wyoming* the level of disclosure that is required. With this latest ruling, the Fifth Circuit has chosen to adopt a balanced, pragmatic approach that takes into account the interests of the bankruptcy estate and individual voting creditors.

Conclusion

The Fifth Circuit's decision in *Texas Wyoming* partially bridges the sharp divide between the competing views on the degree of specificity in a chapter 11 plan necessary to preserve postconfirmation litigation claims. Although debtors in the Fifth Circuit would do well to remember that the claim-reservation language in a chapter 11 plan and disclosure statement must be “specific and unequivocal,” the threat of a strict straitjacket no longer looms large.

Interestingly, yet another Texas bankruptcy court addressed this issue in a ruling handed down the day after the Fifth Circuit issued its opinion in *Texas Wyoming*. In *In re Crescent Resources*, 2011 WL 3022567 (Bankr. W.D. Tex. July 22, 2011), the court held that the requirement for a plan to contain “specific and unequivocal” language reserving claims to be pursued postconfirmation allows the use of the “categorical approach,” in which claims are described by category rather than by the specific defendants to be sued.