In re Lothian Oil: No Tolling of Statute of Limitations for Chapter 11 Plan Revocation

March/April 2013

Laura L. Swanson
Mark G. Douglas

Confirmation of a chapter 11 plan providing for the reorganization or liquidation of a debtor is the culmination of the chapter 11 process. To promote the fundamental policy of finality in that process, the general rule is that a final confirmation order is inviolable. The absence of certainty that the transactions effectuated under a plan are valid and permanent would undermine chapter 11's fundamental purpose as a vehicle for rehabilitating ailing enterprises and providing debtors with a fresh start. The importance of finality in this context was the subject of a ruling recently handed down by the Fifth Circuit Court of Appeals. In *Anti-Lothian Bankr. Fraud Comm. v. Lothian Oil, Inc. (In re Lothian Oil, Inc.)*, 2013 BL 17873 (5th Cir. Jan. 23, 2013), the court ruled that the 180-day limitation period in section 1144 of the Bankruptcy Code for seeking revocation of a plan-confirmation order on the basis of fraud may not be tolled.

Revocation of an Order Confirming a Plan

A limited exception to the rule of finality of the confirmation of a chapter 11 plan can be found in section 1144 of the Bankruptcy Code. Section 1144 provides that, on the request of a party-in-interest made any time before 180 days after the entry of an order of confirmation, the bankruptcy court "may revoke such order if and only if such order was procured by fraud." If the court exercises its discretion to revoke a confirmation order, the statute further provides that the revocation order "shall—(1) contain such provisions as are necessary to protect any entity acquiring rights in good faith reliance on the order of confirmation; and (2) revoke the discharge

of the debtor." Section 1144 is designed to restore the parties to their pre-confirmation positions, as long as the rights of third parties who relied on the plan in good faith are protected. The extreme difficulty of doing so in most cases means that revocation is generally regarded as a drastic remedy for the bankruptcy court to employ.

The court must specifically find that the order was procured by fraud before revoking a confirmation order. The fraud need not have been committed by the debtor or any other proponent of the plan. Fraud committed during a chapter 11 case that is unrelated to plan confirmation is not a basis for revocation—the bankruptcy court can implement other remedies designed to punish the malefactor or remedy any resulting harm, such as the entry of a judgment against the perpetrator. On its face, section 1144, unlike its predecessor provision under the former Bankruptcy Act, does not require the party seeking revocation to have been unaware of the fraud at the time the plan was confirmed.

A defense frequently invoked in connection with a revocation request is that the party seeking revocation knew or should have known of the fraud prior to confirmation. Unless the party in question is the plan proponent, who has affirmative duties of disclosure and good faith, such knowledge is not a bar to revocation under section 1144, although the party seeking revocation may be required to justify its failure to call the fraud to the court's attention when it occurred.

Section 1144 does not explain the meaning of "fraud." As a consequence, it has been left to the courts to fashion a definition. They have done so by looking to the traditional elements of fraud under common law and precedent construing section 1144, the revocation provisions under other

chapters of the Bankruptcy Code, and their predecessors under the former Bankruptcy Act, all of which are similar enough to be informative in assessing the kind of conduct that can justify revocation of an order confirming a chapter 11 plan. Many courts construe "fraud" in section 1144 to mean "fraud on the court." In addition, most courts require a showing of actual fraudulent intent. The fraud can consist of either material misstatements or omissions in the face of a duty to disclose information.

Even if it finds that actionable fraud was committed, the bankruptcy court is not obligated to revoke a confirmation order. Section 1144 gives the court considerable discretion to fashion whatever remedy is appropriate under the circumstances to achieve an equitable outcome. If, for example, it is too late to remedy fraud, or if revoking a confirmation order and restoring the *status quo ante* would be impractical, the court may exercise its discretion to deny revocation in lieu of more effective and less disruptive remedies.

Importantly, the 180-day period specified in section 1144 is absolute. Unlike certain other deadlines contained in the Bankruptcy Code, it may not be extended by the court, even if fraud in procuring a confirmation order is not discovered until after the 180-day period expires. The Fifth Circuit reaffirmed the importance of strict compliance with these requirements in the service of finality in *Lothian Oil*.

Lothian Oil

Lothian Oil, Inc. ("Lothian") filed for chapter 11 protection on June 13, 2007, in Texas. That same day, Lothian filed motions to approve settlement agreements with two creditors resolving lawsuits previously brought by Lothian to protect properties on which the creditor entities, both

headed by a company called the Belridge Group ("Belridge"), were trying to foreclose. In response, an unofficial group of shareholders (the "ad hoc committee") tried to block approval of the settlements, claiming that the agreements amounted to fraudulent transfers because the properties were being surrendered to Belridge without appropriate compensation. The bankruptcy court approved the settlement agreements on June 16, 2007.

On June 10, 2008, the ad hoc committee filed a motion to set aside the settlement agreements under Rule 9024 of the Federal Rules of Bankruptcy Procedure. Rule 9024, with certain exceptions, makes Fed. R. Civ. P. 60 applicable in bankruptcy cases. Civil Rule 60 provides that the court may relieve a party from an order or judgment due to, among other things, "mistake, inadvertence, surprise, or excusable neglect," "newly discovered evidence," fraud, or "any other reason that justifies relief." A request for relief under Rule 9024 and Civil Rule 60 must be made no later than one year following entry of the challenged order or judgment. However, Rule 9024(3) makes an exception to the application of Civil Rule 60, providing that "a complaint to revoke an order confirming a plan may be filed only within the time allowed by § 1144 [of the Bankruptcy Code]."

On June 27, 2008, the bankruptcy court confirmed a chapter 11 plan for Lothian that incorporated both settlements with Belridge. However, the confirmation order preserved the ad hoc committee's right to request that the 2007 settlement orders be set aside under Rule 9024. Most ad hoc committee members subsequently resolved their objections to the settlements.

On June 29, 2009, more than a year after confirmation, nonsettling members of the ad hoc committee and certain other parties challenged the 2007 settlement orders and requested that Lothian's chapter 11 plan be set aside under Rule 9024 due to recently discovered fraud. Although the bankruptcy court dismissed the request without prejudice, a substantially similar group of plaintiffs (the "Anti-Lothian Group") then filed a motion under Rule 9024 to "clarify or modify" the plan by setting aside the settlement orders and avoiding the payment of illicit fees.

The bankruptcy court held that the confirmation order was final, deeming the Anti-Lothian Group's motion to set aside the settlement orders an attempt to relitigate matters that were or should have been contested when the plan was first confirmed. The court ruled that the motion was barred by the 180-day limitation period for revoking a plan-confirmation order under section 1144. It also addressed the merits, finding that there was no mistake, inadvertence, fraud, or other cause shown to set aside the settlement orders.

The district court affirmed on appeal. According to the district court, not only is Rule 9024 expressly subject to the 180-day limitation in section 1144, but the Anti-Lothian Group's request to set aside the settlement was untimely filed under both section 1144 and Rule 9024.

The Fifth Circuit's Ruling

A three-judge panel of the Fifth Circuit affirmed in an unpublished ruling. The Anti-Lothian Group argued that its motion was not an attempt to revoke the confirmed plan but merely sought a modification of the plan to undo fraudulent transfers and recover illicit fees paid by the estate. The appellant also claimed that, because the plan itself "made room" for the initial 9024 motion by the ad hoc committee, the current "attack" on the challenged transactions was merely in

keeping with that carve-out. Finally, the Anti-Lothian Group contended that any delay in the filing could be excused by newly discovered evidence of certain conflicts of interest which tainted the settlements. The Fifth Circuit rejected each of these arguments.

At the outset, the court ruled that the Anti-Lothian Group lacked standing to seek modification of the plan. "Even if we accept the dubious proposition that the [motion] merely sought modification of the plan," the Fifth Circuit wrote, "only the plan's proponents or the debtor may modify a confirmed plan" under section 1127 of the Bankruptcy Code. Because the Anti-Lothian Group neither sought court permission to bring a derivative action on Lothian's behalf nor claimed that any such request would be futile, the Fifth Circuit held that the appellant "thus lacks the requisite standing to make a motion to modify the Confirmed Plan."

The Fifth Circuit agreed with the lower courts' determinations that the Anti-Lothian Group's motion was untimely under both section 1144 and Rule 9024. It was critical of the Anti-Lothian Group's contention that the normal limitation period governing a challenge to a chapter 11 plan should be excused on the basis of recently acquired evidence of fraud. Even if the Anti-Lothian Group had put forth sufficient evidence of this "newness," which it did not, the Fifth Circuit concluded, any form of tolling is explicitly precluded by the text of both section 1144 and Rule 9024. According to the court, because those provisions explicitly treat fraud, "it would make little sense to toll the limitations period of rules designed to deal with fraud because fraud was present." Finally, the Fifth Circuit held that the carve-out in Lothian's chapter 11 plan applied only to the ad hoc committee's Rule 9024 motion.

Outlook

Lothian Oil illustrates the importance of the finality of an order confirming a chapter 11 plan, as well as the exacting scrutiny that courts will bring to bear on any attempt to attack a confirmation order outside the normal appellate process, regardless of how such a challenge is denominated. The requirements of section 1144 are strictly construed. The message of *Lothian Oil* is aptly summed up by the Fifth Circuit's citation to the U.S. Supreme Court's ruling in *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992), for the proposition that "[d]eadlines may lead to unwelcome results, but they prompt parties to act and they produce finality."